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Book Reviews

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The Journal of SOCIAL, POLITICAL AND ECONOMIC STUDIES

Roger Pearson
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China's Ballistic Missile Threat

James H. Hughes[1]
Englewood, Colorado

The author examines in detail the on-going Chinese build-up of ballistic missile forces, and suggests the potential impact of this build-up on the balance of forces as against, in particular, Taiwan and the United States.

Key Words: China, ballistic missiles, MIRVs, cruise missiles, United States' missile strategy, Taiwan's defense, non-nuclear weapon strategy

Ballistic Missiles as a Key Element in China's Military Transformation

China is building short, intermediate, and long-range ballistic missiles with which it could threaten the United States and numerous other countries. The situation is potentially parallel to that reached in China's relations with Taiwan, when in 1995 and 1996 it was able to threaten Taiwan with ballistic missile "test" firings. There are indications that China's ballistic missile buildup reflects a strategy of using missiles for deep, rapid strikes directed at an opponent's air and naval forces, and at radar, naval, and air bases, without first requiring air superiority.

In contrast to U.S. military strategy, which relies heavily on air power, Chinese missile strategy appears to involve the use of ballistic missiles as a counterforce strike against an opponent's military forces, seizing the initiative and taking advantage of the element of surprise. America's perception of the use of ballistic missiles in a counterforce strike appears limited, reflecting a Cold War context of nuclear-armed ICBMs targeted at missile silos, long-range bomber bases, Trident submarine bases, and command and control centers. But counterforce strategy may be applied to use non-nuclear, accurate ballistic missiles targeted at conventional air and naval forces. Such a strategy would be unusual for the United States, as the U.S. relies predominately on air power and has not encountered a similar strategy since the end of the Cold War.

With the exception of some tactical short-range multiple rocket launchers, the United States uses ballistic missiles only for deterrence. In contrast, China evidently contemplates the use of ballistic missiles both for aggression and deterrence. For example, on March 6, 2000 the PLA (People's Liberation Army) newspaper Liberation Army Daily noted China "is a country that has certain abilities of launching strategic

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counterattack and the capacity of launching a long-distance strike... It is not a wise move to be at war with a country such as China, a point which the U.S. policymakers know fairly well also."[2]

China's strategy has resulted in the development of a variety of non-nuclear weapons such as radio-frequency warheads that generate a powerful electromagnetic pulse disabling electronics, computers and radar; and cluster munitions to disable runways and air bases.[3] It has developed warheads for penetrating hardened command posts; and warheads using fuel-air explosives that produce three to five times the blast damage of conventional high-explosives, similar to what the United States used in Afghanistan.[4] China has, in addition, developed maneuverable warheads for its short-range ballistic missiles to evade ballistic missile interceptors like the Patriot missiles Taiwan has deployed around Taipei. It has reduced the radar signature of its short-range DF-11 and DF-15 ballistic missile warheads to evade detection. It has tested chaff, jammers, and other countermeasures.[5]

The variety of its warheads combined with its development of accurate missiles has given China a potent arsenal for deep penetration, first strike weapons in conventional warfare. It was would evident that China plans to use its ballistic missiles in tactical military situations – in attacking air and naval forces and bases, not just as terror weapons as seen in the 1991 Persian Gulf War. China is developing the ability to use ballistic missiles to penetrate an opponent's air and missile defenses, weakening an opponent to create a favorable playing field for the rest of its armed forces. This strategy goes beyond what the U.S. has confronted in Afghanistan, Yugoslavia, or the Gulf War.

American Assessment of Chinese Strategy

China's ballistic missiles form a key element in its military transformation. By using ballistic missiles accurate to within tens of meters, China can conduct deep, precision strikes without necessarily resorting to nuclear weapons. Its missiles can help achieve a form of blitzkrieg or lightning warfare, striking faster and deeper than tanks or aircraft. Recogniz-

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[2] Congressman Floyd D. Spence, "China in the Ascendancy," *National Security Report*, Vol. 2, No. 2, May 2000, p. 2.

[3] Richard D. Fisher, Jr., China Increases Its Missile Forces While Opposing U.S. Missile Defense (Washington, D.C.: *The Heritage Foundation, Backgrounder* No. 1268, April 7, 1999), p. 8.

[4] Richard J. Newman, "The Chinese Sharpen Their Options," *AIR FORCE Magazine*, October 2001, p. 59.

[5] Ibid.

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ing the importance of ballistic missiles to China's military planning, the CIA's January 2002 report on "Foreign Missile Developments and the Ballistic Missile Threat Through 2015" noted:

> China's leaders calculate that conventionally armed ballistic missiles add a potent new dimension to Chinese military capabilities, and they are committed to continue fielding them at a rapid pace. Beijing's growing SRBM [short-range ballistic missile] force provides China with a military capability that avoids the political and practical constraints associated with the use of nuclear-armed missiles. The latest Chinese SRBMs provide a survivable and effective conventional strike force and expand conventional ballistic missile coverage.[6]

While the CIA report limits China's military transformation to its short-range ballistic missile forces, or in other words its threat to Taiwan, the observation made by the CIA report in that context may be applied, as well, to its intermediate and long-range ballistic missiles that can reach U.S. forces in the Pacific and the United States. China's intermediate and long-range ballistic missiles give it a military capability that avoids the constraints associated with the use of nuclear-armed missiles.

The June 2000 Department of Defense "Annual Report on the Military Power of the People's Republic of China" noted that China apparently plans to use its ballistic missiles in an asymmetrical assault directed against Taiwan's airpower. The report noted, "China's SRBMs likely would target air defense installations, airfields, naval bases, C4I [command, control, communications, computers, and intelligence] nodes, and logistics facilities."[7] Explaining China's ballistic missile strategy, the report added:

> Chinese strategists believe that if a war against a technologically superior foe breaks out, the enemy likely will deploy forces rapidly and then launch a massive air campaign. While the enemy is assembling its forces, there exists a window of opportunity for preemptive attack. This approach – "gaining the initiative by striking first" – is viewed as an effective method to offset or negate the advantages possessed by a more advanced military foe.[8]

Understood in this way, China's nuclear missile strategy is elegant and aggressive. To respond to a numerically larger nuclear missile deterrent,

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[6] National Intelligence Council (CIA), Foreign Missile Developments and the Ballistic Missile Threat to the United States Through 2015, January 2002, p. 10.

[7] Department of Defense, *Annual Report on the Military Power of the People's Republic of China*, June 2000, p. 17.

[8] Ibid., p. 8.

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China plans to threaten a handful of cities of a potential opponent confident that a threat directed against even a small number of cities can deter a western country, and forestall any intervention that may arise over Taiwan.

China's Statements About Its Strategy

This strategy is articulated by the Chinese themselves in August 19999 in a Central Military Commission (CMC) planning document for war against Taiwan, chaired by President Jiang Zemin:

> Based on strategic considerations, the CMC has decided to disclose, when appropriate, some information on strategic weaponry so that the U.S. will exercise some caution in decision-making, and be aware that it would have to pay a price if it decided to intervene in a military conflict. The purpose is to prevent the U.S. from being deeply involved even if a war becomes unavoidable so that the losses on both sides of the Taiwan straits will be minimised throughout the war...
>
> So far we have built up the capability for the second and the third nuclear strikes and are fairly confident in fighting a nuclear war. The PCC [Chinese Communist Party] has decided to pass through formal channels this message to the top leaders of the U.S.[9]

The second paragraph evidently implies a first strike as noted by the *Liberation Army Daily*. China's capability for second and third strikes are apparently intended to deter an opponent with larger forces. Confirming how China believes its smaller nuclear forces can effectively deter a stronger opponent, in October 2001 one Chinese analyst explained, "It is not necessary for China to seek a nuclear balance with the US. If we have the capacity to launch a nuclear counterattack, there will be no difference between 10 and 10,000 nuclear warheads."[10]

China's ballistic missiles are apparently not only for deterrence, but make up the tip of its spear. Its ballistic missile buildup would be expected to affect planning by countries intending to build a ballistic missile defense and may believe themselves threatened.

China's Opposition to U.S. Ballistic Missile Defense

Because China's military strategy relies heavily on ballistic missiles,

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[9] Document of the Central Military Commission (OCMC), Serial No. 65, August 10, 1999, pp. 6.

[9] "China Prepares for War," InsightMag.com, downloaded May 2000: http://www.insightmag.com/archive/200003057.shtml.

[10] Wu Zichen, "China's twisted road to coexistence," *Asia Times Online* (with *Heartland*), October 13, 2001.

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China opposes a U.S. ballistic missile defense. In an interview two days after the terrorist attacks of September 11, the authors of Unrestricted Warfare, a PLA textbook, criticized a U.S. ballistic missile defense saying, "September 11, 2001 probably marks the beginning of U.S. decline as a superpower. The attacks demonstrated the U.S. fragility and weakness and showed that, basically, it is unable to withstand attacks. The National Missile Defense system cannot save it."[11]

It is perhaps a reflection of China's strategy that the September 11 terrorist attacks and war in Afghanistan have drawn attention away from both China's ballistic missile buildup and the United States' ballistic missile defense. Although China has been welcomed for its role in the war against terrorism, not much attention has been given to its role in supporting the Taliban up to September 11.[12] Recognizing the likelihood that the United States will deploy a ballistic missile defense, China is developing ways to overcome that defense. These include its buildup of ballistic missiles and its development of MIRVs to saturate a limited defense. In addition, it plans to threaten specific components of the defense. As noted by Sha Zukang, China's top arms control official, China plans to concentrate on a range of relatively low-cost responses to defeat a ballistic missile defense, such as by striking at the radar network and communication nodes that would form the nervous system of the defense.[13] He added:

> We will do whatever possible to ensure that our security will not be compromised, and we are confident that we can succeed without an arms race. We believe defense itself needs defense. . . . It has many, many parts and most of them are vulnerable to attack.[14]

China's Buildup

China has 20-to-24, or more, CSS-4 ICBMs (other estimates range from 18-26 CSS-4s), also known as the DF-5 or DF-5A, which are capable of reaching the United States. In October 2001, Secretary of State Colin Powell noted that China has pointed these missiles at American cities.[15]

China's CSS-4s may number a total of more than 20-24. As noted by

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[11] J. R. Nyquist, "China Supports bin Laden And The Taliban," Financial Sense.com, October 10, 2001.

[12] John Pomfret, "China Strengthens Ties With Taliban by Signing Economic Deal," Washington Post, September 13, 2001. Also: K. J. M. Varma, "China assisting us in war against US: Taliban commander," hindustantimes.com, October 22, 2001.

[13] Michael R. Gordon, "China Looks to Foil U.S. Missile Defense System," *New York Times*, April 29, 2001.

[14] Ibid.

[15] PTI, "China will continue to target US Cities," hindustantimes.com, October 23, 2001.

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one source, China may be storing additional CSS-4s in tunnels for second or third strikes.[16] It is developing MIRVs (Multiple Independently targeted Reentry Vehicles) and decoys that may be retrofitted to existing ICBMs, giving China the ability to attack a larger number of cities or military targets, and to defeat a limited ballistic missile defense.[17] In 2001, China moved its 24 CSS-4 ICBMs.[18] This could have been for retrofitting them with MIRVs, refurbishing them, giving them improved guidance, or putting them in a new launch location, but the reason was not publicly discussed.

In addition to its CSS-4 ICBMs and latent ability to use Long March space launch vehicles as ICBMs (Long March space launch vehicles were derived from ICBMs), China is building three new types of long-range ballistic missiles: the road-mobile, solid-fuel DF-31 ICBM; the longer-range, solid-fuel road-mobile DF-41 ICBM; and the submarine-launched JL-2 derivative of the DF-31.These new missiles are expected to be accurate, giving China the ability to attack an opponent's air and naval bases, radar, missile silos, and command and control centers.

With its development of accurate ballistic missiles, China has moved to a first strike counterforce capability for its ICBMs, as well as for its short and intermediate-range ballistic missiles. It can potentially threaten U.S. bases and forces in the Pacific, and potentially deter intervention to defend Taiwan. China's ballistic missile program may no longer be characterized as only for retaliation or deterrence, but may include a use for aggression.

Testing of Missiles and Reentry Vehicles

These new ICBMs are not just on the drawing board. In August 1999 China flight-tested the DF-31.It may have made a second flight test in June 2000.[19] Another, possibly third, flight test may have been conducted in November 2000 during General Henry H. Shelton's visit to China. Then in December 2000 there was still another DF-31 flight test.[20] In January

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[16] Yang Zhen, "China's Nuclear Arsenal," National University of Singapore, March 16, 1996.

[17] Richard D. Fisher, Jr., Op. Cit., pp. 4-6.

[18] Complied by Bill Gertz, "China modernizing its ICBM forces," Geostrategy- Direct.com, May 8, 2001.

[19] Bill Gertz, The China Threat (Washington, D.C.: Regnery Publishing, Inc., 2000), pp. 182-184. Richard D. Fisher, Jr., Op. Cit., p. 4. Bill Gertz, Betrayal (Washington, D.C.: Regnery Publishing, Inc., 1999), pp. 94-95.

[20] Possible Third Flight Test: "US 'Expects Mainland Missile Test,'" *South China Morning Post*, June 8, 2000."US Forces Beefing Up Surveillance on China Missile Test: Report," China Times, June 7, 2000.

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2002, China attempted a flight test of the DF-31 reentry vehicle. Although reports conflict on whether the booster was a space launch vehicle or DF-31 and although the missile blew up in mid-flight, the test shows steps are being taken in the DF-31 program.[21]

Significantly, the January 2002 reentry vehicle flight test was for a MIRV. As noted by some commentators, China sees an expanded ICBM force using MIRVs as key to overcoming a potential ballistic missile defense and maintaining the deterrent value of a smaller force of nuclear missiles. They note that as China adds a MIRV capability, a limited ballistic missile defense designed around North Korea's threat would prove largely ineffective against China.[22] In 2002 China evidently stepped up its MIRV testing program.[23]

The maturity of China's DF-31 ballistic missile program may be seen in the fact that in mid-January 2001 it launched at sea a JL-2 (Ju Lang or "Giant Voice") DF-31 SLBM derivative, thought to be for China's Project 094 nuclear ballistic missile submarine in development at Huludao.[24] The test of the JL-2 derivative would indicate the DF-31 is at an advanced stage of development, involving an ability to use the missile in a different mode of deployment – on a submarine – as well as by being carried by road-mobile transporter.

While China's Project 094 ballistic missile submarine has been deferred in favor of its Project 093 nuclear attack submarine, the JL-2 may be deployed on other submarines like its Golf-class diesel submarines, or on ships.[25] In October 2001 China conducted a "pop-up" test of the JL-2 from a modified Golf-class submarine, which simulated the firing of a ballistic missile from a submarine, ejecting the missile from a tube.[26] In Feb-

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Third and Fourth Flight Tests: Francesco Sisci, "China's Missile Test a Warning to U.S.," *Straits Times*, December 14, 2000.CNA, "MND Aware of Mainland China's ICBM Testing," December 13, 2000.Bill Gertz, "Pentagon confirms China's missile test," *Washington Times*, December 13, 2000.Bill Gertz, "China runs 2nd test of long-range missile," *Washington Times*, December 12, 2000.

[21] "China Tests Shield-Busting Missile, Report," CNN.com, February 5, 2002. Space Launch Vehicle used for test of DF-31 reentry vehicle: Bill Gertz and Rowan Scarborough, "Failed DF-31 test," Inside the Ring, *Washington Times*, January 4, 2002.

[22] Ibid.

[23] Oliver August, "Chinese test new missile threat to US shield," *The Times* (UK), February 12, 2002.

[24] A. D. Baker III, "World Navies in Review," Vol. 127, No. 3, March 2001, U.S. Naval Institute Proceedings, pp. 32-45.

[25] Ibid.

[26] Bill Gertz and Rowan Scarborough, "China tests JL-2," Inside the Ring, November 2, 2001.Also: "China carries out 'pop-up' test of submarine-launched JL-2 missile," Geostrategy-Direct.com, December 4, 2001.

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ruary 2002 it was reported that China expects to conduct another pop-up test.[27]

With a range of 8,000 km (about 5,000 miles) the DF-31 can attack the western United States and U.S. forces in the Pacific. The significance of DF-31's threat deserves explanation. Some analysts do not view it as a serious threat because its range is limited to the western United States. However, this overlooks how the DF-31 forms part of China's "Long Wall Project" aimed at U.S. forces in the Pacific.[28] As noted by the Taipei Times in May 2001:

> The Long Wall Project is aimed at the US, not Taiwan. The Chinese military leadership plans to put longer-range ballistic missiles in the southeastern provinces so that they can cover US military targets in the Pacific . . .
>
> They can fire, for instance, a Dong Feng-31 at a US navy battle group shortly after the group leaves its base in Hawaii. The Long Wall Project is basically a deterrent against the US' fighting forces in the Pacific . . .[29]

China's threat of using the DF-31 against naval vessels needs to be treated seriously. This threat would most likely come as a complete surprise to U.S. naval forces as little thought or discussion has been given to the use of ballistic missiles against naval forces at sea or in port – ballistic missiles are often treated as non-precision weapons. However, China is building satellites capable of ocean surveillance and the real-time reconnaissance of naval forces. Its first ocean color surveillance satellite, the Haiyang-1 or HY-1 (Haiyang means "ocean"), is expected to be launched by June 2002.[30] China has launched the Ziyuan-1 and Ziyuan-2 earth resource satellites, ZY-1 and ZY-2 (Ziyuan means "resource"), believed to be used to spy on foreign military forces. The ZY-2 is believed to have a photographic resolution of nine feet.[31]

The Taipei Times reported China has built two bases for the DF-31 in its southeastern provinces and plans to build more bases as part of its

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[27] Bill Gertz and Rowan Scarborough, "Chinese sub test," Inside the Ring, February 1, 2002.

[28] Brian Hsu, "China builds new missile platforms to deter US forces," *Taipei Times*, May 7, 2001.

[29] Ibid.

[30] Wei Long, "Ambitious Space Effort Challenges China In Next Five Years," SpaceDaily.com, September 18, 2001.

[31] "China's Spacecraft," Space Today Online – Chinese Satellites and Spacecraft, downloaded December 2001.

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"Long Wall Project."[32] Additional evidence of deployment was reported in September 2001 by the Washington Times. It noted the PLA had begun "crew training" for the DF-31 road-mobile launchers. According to this source, U.S. intelligence detected China's first missile units equipped with DF-31s in July 2001.An operational capability was expected by the end of 2001.[33] In the Washington Times article, an intelligence official admitted, "This is a faster deployment schedule than was expected."[34] In February 2002, an analyst noted, "It looks like the Chinese are much further [ahead] than we originally thought."[35]

China is developing a larger, longer-range road-mobile ICBM, the DF-41 that is expected to be capable of reaching most of the United States, and it will be MIRVed with five to eight nuclear warheads. In testing the DF-41, China is using computer simulations.[36] However, as the DF-41 is not as advanced in development as the DF-31, it may be abandoned. China may substitute longer-range versions of the DF-31 in its place.[37]

China is also building new intermediate-range ballistic missiles such as the DF-21-X and DF-25, which can potentially attack U.S. forces in the Far East and Pacific.[38] It is producing CSS-7 (DF-11 or M-11) short-range ballistic missiles, and updating the CSS-6 (DF-15 or M-9) with satellite navigation.[39] Its short-range ballistic missiles have been observed to be accurate within 50 meters, and greater accuracies are expected.[40] As noted by the CIA report, these ballistic missiles will provide China with "a potent new dimension" of military transformation.[41] This transformation may affect its neighbors in the Far East.

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[32] Brian Hsu, "China builds new missile platforms to deter US forces," *Taipei Times*, May 7, 2001.

[33] Bill Gertz, "Rumsfeld says missiles proof of China's global ambitions," *Washington Times*, September 7, 2001.Bill Gertz, "China Ready to Deploy its First Mobile ICBMs," *Washington Times*, September 6, 2001.

[34] Ibid.

[35] Oliver August, Op. Cit.

[36] CNA, "Beijing Simulates Long-Range Missile Launch: Report," October 15, 1999.

[37] Willy Wo-Lap Lam, "China's Military Set for Budget Boost," CNN.com, February 8, 2002.Bill Gertz, "Report upgrades China's threat as a nuclear power," *Washington Times*, January 11, 2002.

[38] Jack Spencer, The Ballistic Missile Threat Handbook (Washington, D.C.: The Heritage Foundation, 2000), pp. 24-27.

[39] Richard J. Newman, Op. Cit., pp. 58-61.Richard D. Fisher, Jr., Op. Cit., p. 7.

[40] Richard J. Newman, Op. Cit., pp. 58-61.Brian Hsu, "M-class missile's bark worse than bite: military," *Taipei Times*, August 16, 2000.

[41] National Intelligence Council (CIA), Op. Cit., p. 10.

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Taiwan

By 2001, China had deployed 350-400 short-range ballistic missiles near Taiwan, and was adding 50 missiles a year. In February 2002 it was estimated to have deployed over 400 missiles near Taiwan.[42] In March 2001, China increased production of the short-range CSS-7 (DF-11 or M-11) by a factory at Yuanan, part of its Sanjiang missile group, about 175 miles west of the provincial capital of Wuhan in Hubei province.[43] Intelligence estimates of China adding 50 short-range ballistic missiles a year near Taiwan may correspondingly need to be revised upwards. By 1998, China had deployed fewer than 50 short-range ballistic missiles near Taiwan, but by the end of 1999 this increased to 150 missiles.[44] In 2001, the number of missiles jumped to 350-400, which indicates that the estimated addition of 50 missiles a year is only approximate. Part of this jump may have come from the re-deployment of existing missile forces as well as from the production of new missiles.

By using hundreds of short-range ballistic missiles, China could overwhelm Taiwan's Patriot missile defense in a massive salvo. It could attack Taiwan's C4I, radar, air defenses, air bases, naval bases, and other military facilities.[45] Its 350-400 or more M-9 and M-11 short-range ballistic missiles near Taiwan give it the ability to strike a swift, powerful blow. The M-9 (CSS-6 or DF-15) has a range of 360 miles. The M-11 (CSS-7 or DF-11) has a range of 180 miles.[46]

In December 1999 China was reported to be preparing to deploy hundreds of its new longer-range CSS-7 Mod 2 missiles, which have a range of 300 miles. The new CSS-7 Mod 2s are expected to carry several types of warheads, including high-explosives, cluster bombs, and fuel-air explosives. It could carry small nuclear warheads such as the small Chinese nuclear warhead the CIA believes was built using U.S. technology for the Trident W-88 warhead.[47]

In March 2001, according to an article in the Washington Times,

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[42] Liu Kuan-teh, "Beware Beijing's military threat," *Taipei Times*, February 16, 2002.

[43] Bill Gertz, "China beefs up missile stocks," *Washington Times*, March 27, 2001.CNA, "China Deploying over 400 Missiles Opposite Taiwan," August 8, 2000. Nadia Tsao, "US underestimates China's threat," *Taipei Times*, July 21, 2000.

[44] Bill Gertz, "China adding missiles aimed toward Taiwan," the Washington Times, February 5, 2001.

[45] Department of Defense, Annual Report on the Military Power of the People's Republic of China, June 22, 2000, p. 8-10.

[46] Richard D. Fisher, Jr., Op. Cit., pp. 4-6. Also: Federation of American Scientists Website, updated July 28, 2000. Jack Spencer, Op. Cit., pp. 24-25.

[47] Bill Gertz, "China Targets Taiwan with 2nd Missile Base," the Washington Times, December 8, 1999.

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China is deploying the CSS-7 Mod 2 (M-11 or DF-11) at new bases in the coastal province of Fujian at Xianyou 135 miles from Taiwan, and Yongan 220 miles from Taiwan. Each base is estimated to house a brigade of 16 truck launchers and 97 CSS-7 missiles, and has tunnels – underground bunkers – for storing the missiles.[48] A third, older missile base is at Leping, Jiangxi province, 362 miles from Taipei. It houses a brigade of about 100 of the older, longer-range CSS-6 missiles, and is "brigade headquarters" for all PLA ballistic missile units near Taiwan.[49]

In May 2001 the Taipei Times reported China's deployment of short-range ballistic missiles in Fujian province at Xienyu (Xianyou), Pingtan, and Lienchen (suggesting more bases).[50] In June 2001 the PLA activated a CSS-6 missile training base at Fuzhou, directly across the Taiwan Strait from Taipei.[51] In addition, China is developing a maneuverable warhead for the DF-15, making it more difficult for Taiwan to intercept it with Patriot missiles.[52]

China's buildup of short and intermediate-range ballistic missiles is noteworthy. According to one source, it may build up to 1,000 theater-class ballistic missiles in the next decade, most of them with a range between 180 and 1,200 miles.[53] This would presumably be in addition to its existing arsenal. Another source credits China with having 650 DF-15 (CSS-6 or M-9) missiles and 200 DF-11 (CSS-7 or M-11) missiles, or a total of 850 short-range ballistic missiles as of 2000, not counting other short-range and intermediate-range ballistic missiles.[54]

U.S. Response

The United States has apparently ignored China's ballistic missile buildup. Under President Clinton the United States seemed to downplay the threat. For example, General Henry H. Shelton, Chairman of the

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[48] Bill Gertz, "China places second missile base near Taiwan," the Washington Times, March 15, 2001.Bill Gertz, "China Targets Taiwan with 2nd Missile Base," the Washington Times, December 8, 1999.

Also: CNA, "China Deploying over 400 Missiles Opposite Taiwan: Report," China Times Inter@ctive, August 9, 2000.

[49] Bill Gertz, "China places second missile base near Taiwan," the *Washington Times*, March 15, 2001.Bill Gertz, "China Targets Taiwan with 2nd Missile Base," the *Washington Times*, December 8, 1999.

[50] Brian Hsu, "China builds new missile platforms to deter US forces," *Taipei Times*, May 7, 2001.

[51] Bill Gertz, "Chinese missile moves near Taiwan worry U.S.," the *Washington Times*, June 7, 2001.

[52] Richard J. Newman, Op. Cit., p. 59.

[53] Ibid.

[54] Jack Spencer, Op. Cit., pp. 24-25.

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Joint Chiefs of Staff, who in December 2000 warned about China's growing military capability, omitted mention of China's DF-31 flight test that occurred during his visit to China the month before.[55] Pentagon spokesman Ken Bacon downplayed that flight test of the DF-31, saying, as reported by the Washington Times in December 2000, "I don't think its fair to say that this building [the Pentagon] or this government is worried about what they see in China . . ."[56]

This Pentagon spokesman may best describe America's response to China's ballistic missile buildup. The United States is apparently not worried by China's ballistic missile buildup. This lack of concern may be seen in how the United States responded to China's threat in 1995 to use a ballistic missile if it intervened on behalf of Taiwan. As recorded by Washington Times reporter Bill Gertz, State Department spokesman Glyn Davies seemed to dismiss China's threat, saying:

> There is no outstanding nuclear threat against the United States from China, and it's silly to build this up into anything more than it is, which is some low-level official [PLA General Xiong Guangkai] saying something that could perhaps have been interpreted that way, and that was irresponsible to begin with.[57]

Echoing this downplaying, in 1996 President Clinton used his State of the Union address to claim there were no nuclear missiles pointed at America's children. His claim was apparently based on an unverified promise of targeting that Russia could change in minutes, and did not note China's reported targeting of American cities. If the United States decides to build a ballistic missile defense to counter China's threat, it may need to change its perceptions.[58]

While the new Bush administration brought with it a perception that the threat is real, its perceptions of a ballistic missile threat apparently do not extend to China. However, CIA Director George Tenet showed an awareness of the relationship between China's growing military and economic power and diplomacy when in February 2002 he testified before Congress, warning that while the September 11 terrorist attacks "changed the context of China's approach" to the United States, they did not

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[55] Bill Gertz, "Gen. Shelton sees China as growing threat to U.S.," *Washington Times*, December 15, 2000.

[56] Bill Gertz, "Pentagon confirms China's missile test," *Washington Times*, December 13, 2000.

[57] Bill Gertz, Betrayal, Op. Cit., p. 91.

[58] Letter from Congressman Bob Schaffer to General Henry H. Shelton, October 7, 1998. Also: Bill Gertz and Rowan Scarborough, "Williams moves on," Inside the Ring, May 25, 2001.

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change the fundamentals of China's military buildup with an ultimate aim of becoming a great power in East Asia.[59]

Mr. Tenet also warned that China had increased its operational military skills to deal with possible military action in the Taiwan Strait and to deter the United States from defending Taiwan in case of an attack. He noted Taiwan "remains the focus of China's military modernization program. "He said, "This is aimed not only at Taiwan but also at increasing the risk to the United States itself in any future Taiwan contingency."[60] Mr. Tenet added, "China also continues to upgrade and expand the conventional short-range ballistic missile force it has arrayed against Taiwan."[61] China called Mr. Tenet's testimony "unreasonable, irresponsible, and unacceptable."[62]

By comparison to Mr. Tenet's warnings, in February 2002 the Director of the Defense Intelligence Agency, Vice Admiral Thomas Wilson, said in separate testimony to Congress that he was less concerned than a year before about the prospects of a major confrontation between China and Taiwan, even though he noted that China's ability to attack Taiwan will have grown significantly by the end of the decade.[63]

However, in February 2002 China's Vice-Foreign Minister Li Zhaoxing emphasized the importance of Taiwan to China by saying, "The Taiwan question remains the most important and most sensitive issue at the heart of China-U.S. relations, and it concerns China's sovereignty and territorial integrity."[64] As alluded to by Mr. Tenet, for four months in 2001 China conducted off Dongshan island the largest military exercises it has ever held, involving 100,000 troops preparing for an invasion of Taiwan's Penghu islands and preparing against potential intervention by the United States.[65]

The finale of these wargames included a flight test of China's road-mobile, intermediate-range CSS-2 (DF-3, DF-3A) ballistic missile. While an Air Force intelligence report said several years ago that the CSS-2 is

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[59] Charles Snyder, "CIA director warns US of China threat," *Taipei Times*, February 8, 2002.

[60] Ibid.

[61] Ibid.

[62] AFP, "Beijing Slams CIA Chief's Warning on Chinese Ambitions," Taiwan Security Research, February 10, 2002.

[63] Charles Snyder, "CIA director warns US of China threat," *Taipei Times*, February 8, 2002.

[64] Xinhua News, "Taiwan at Heart of Sino-US Relations," Taiwan Security Research, February 6, 2002.

[65] AFP, "PLA Flexes its Muscle with Joint Exercises," Taiwan Security Research, August 22, 2001.

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used to target Russia and India, its use in war games preparing for an invasion of Taiwan and to counter U.S. intervention may be an indication of how China plans to use intermediate-range ballistic missiles.[66]

Adding weight to Mr. Tenet's testimony, in February 2002 veteran China watcher Willy Wo-Lap Lam predicted the PLA will be likely to receive at least as large an increase in military spending as it received in 2001, which was 17.7 percent in a deflationary economy. He further noted that the PLA expects to conduct additional test firings of the DF-31; that more advanced models are under development; and that major strides will be made in aeronautics and space warfare, where research and development is financed by civilian government units.[67]

Thought Within the United States

In the midst of China's ballistic missile buildup, which has been occurring for over a decade, in February 2002 Secretary of State Colin Powell remarked that U.S.-China relations are developing "rather smoothly," while acknowledging that there are areas where China and the United States "decidedly did not see eye to eye," including Taiwan, missile proliferation, and religious freedom.[68] Highlighting these differences, in February 2002, in advance of President Bush's visit, China's number-two leader, Li Peng, condemned foreign countries for "interfering" over human rights.[69]

Within the United States there are different schools of thought in evaluating China's potential military threat. Some commentators and analysts see China's buildup as a threat, correlating it with China's long-term policy, goals, and objectives.

Other analysts, such as Ralph Cossa, president of the Pacific Forum in Honolulu, stress the importance of opening and maintaining dialogue with China, and would prefer to debunk the "so-called China threat" theory, even as China begins to deploy a new generation of solid-fuel, mobile ballistic missiles – the DF-31 and JL-2.[70]

Within the Bush administration, the importance of engaging China is

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[66] Bill Gertz, "China Tests Missile in War-Game Finale," *Washington Times*, August 24, 2001.

[67] Willy Wo-Lap Lam, "China's Military Set for Budget Boost," CNN.com, February 8, 2002.

[68] AFP, "US-China Relations Going 'Rather Smoothly': Powell," Taiwan Security Research, February 6, 2002.

[69] AFP, "China's Li Peng Slams Foreign 'Interfering' over Human Rights," Taiwan Security Research, February 11, 2002.

[70] Ralph A. Cossa and Bonnie Glasser, "What should Bush say in Beijing?," *Taipei Times*, February 11, 2002.

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apparently emerging as a priority. People are hesitant to discuss the agreement China signed in November 2000 to halt missile-related sales that could help any country deliver nuclear, biological, or chemical weapons, since as of February 2002 China apparently has not carried out that accord. But as administration officials point out, tangling with China is far more complex than denouncing Iraq, Iran, or North Korea as an axis of evil.[71]

The view de-emphasizing China's potential military threat, however, may not give adequate weight to the views expressed by the PLA. For example, PLA General Xiong Guangkai said in September 2001 that the situation in the Taiwan Strait has become "grimmer and more complex" in the past few years, and that "we shall not commit ourselves to giving up the use of military force."[72] Reinforcing General Guangkai's viewpoint, the PLA has increased its number of short-range ballistic missiles near Taiwan to over 350-400, is adding new missiles, and is building new bases.[73]

China's diplomatic maneuvers include Premier Qian Qichen's overtures to Taiwan in January 2002, which seemed to make a conciliatory gesture softening China's position. Qian Qichen's statements, however, were noted by a Taipei Times editorial as "sweet nothings from poisonous lips."[74] Another commentator observed that Qian's remarks were part of China's strategy to isolate Taiwan's government, being "laced with a political lexicon with which people in Taiwan are familiar."[75] In February 2002, a month after Qian made his speech, China's Vice Foreign Minister Li Zhaoxing firmly reiterated China's demand that Taiwan recognize its interpretation of "one-China," indicating Qian Qichen's remarks were meant to win praise in advance of President Bush's visit to China.[76]

The January 2002 CIA report "Foreign Missile Developments and the Ballistic Missile Threat Through 2015" deserves careful scrutiny. On the one hand, the CIA report candidly notes the transforming power of China's ballistic missile buildup as adding "a potent new dimension to Chinese military capabilities, and they are committed to continue fielding

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[71] David E. Sanger, "China Is Treated More Gently Than North Korea for Same Sin," *New York Times*, Taiwan Security Research, February 21, 2002.

[72] AFP, "PLA Chief Warns on Strait Meddling," Taiwan Security Research, September 12, 2001.

[73] Bill Gertz, "China Increases Missile Threat," *Washington Times*, August 28, 2001.

[74] "Editorial: Sweet nothings from poisonous lips," *Taipei Times*, January 26, 2002. Also: "A question of interpretation," Asia Times Online, January 29, 2002.

[75] Tung Li-wen, "China's new propaganda strategy," *Taipei Times*, February 9, 2002.

[76] Charles Snyder, "Taiwan at top of Sino-US agenda," *Taipei Times*, February 6, 2002.

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them at a rapid pace."[77] On the other hand, the CIA report "projects an SRBM force in 2005 of several hundred missiles" when China already has deployed more than 350-400 SRBMs against Taiwan, and sources credit it with 850 CSS-6 and CSS-7 SRBMs.

The CIA report may be understating China's buildup by hundreds of short-range ballistic missiles. While the CIA report may have restricted its estimate of SRBMs to the new CSS-7 Mod 2, perhaps because of its improved accuracy, this is not explained, nor is a breakdown presented of the types and numbers of short-range ballistic missiles China has deployed and their rate of production. One Chinese military analyst, Richard Fisher, said the CIA's estimates appeared to be too low.[78]

Cruise Missiles

Fisher further noted the report's glaring omission of China's progress in developing a land-attack cruise missile.[79] While this criticism may be unfair since the CIA report was focused on ballistic missile threats and developments, it justly points out the need for adequate threat assessments incorporating both cruise and ballistic missile developments, whether by the CIA or Department of Defense.

China's development of long-range land-attack cruise missiles is noteworthy, and should be added to a discussion of its growing military power, as seen, for example, in its purchase of Russian SS-N-22 supersonic anti-ship cruise missiles acquired with two Russian Sovremenny-class destroyers.[80]

Even though Mr. Tenet's February 2002 testimony before Congress highlighted the relationship between China and the United States over Taiwan, the January 2002 CIA report did not mention the potential danger of China's buildup of short-range ballistic missiles in accelerating the likelihood of conflict between China and Taiwan.

Problems in the U.S. Evaluation

In evaluating China's ballistic threat against the United States, the CIA report does not mention the capability of the DF-31 for attacking U.S. forces in the Pacific, nor does it note that China is building two bases for the DF-31 and reportedly would have achieved an operational capa-

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[77] National Intelligence Council (CIA), Op. Cit., p. 10.

[78] Bill Gertz, "Report upgrades China's threat as a nuclear power," *Washington Times*, January 11, 2002.

[79] Ibid.

[80] Bill Gertz, "China Tests Supersonic Anti-Ship Cruise Missiles," *Washington Times*, September 25, 2001.

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bility by the end of 2001.Instead, the CIA report projects that over the next 15 years "China would have about two dozen shorter range DF-31 and CSS-3 ICBMs that could reach parts of the United States."[81]

The CIA report seems to estimate China's average annual production of DF-31 ICBMs at approximately two per year. Yet the report said China is "committed to fielding them [ballistic missiles] at a rapid pace. "While the report may not have intended to include the DF-31 in this statement, the ommision would seem unusual since China has focused considerable attention on the DF-31, as is apparent from its flight tests and development of the JL-2. In comparison to the CIA's projected production rate of 2 missiles a year, Russia is producing the solid-fuel, road-mobile SS-27 Topol-M at a rate of 6-10 per year. As a technical detail, the CIA report classifies the CSS-3 (DF-4) as an ICBM when other sources classify it as an intermediate-range ballistic missile. However, the CSS-3 with its 3,400-mile range is admittedly on the high side for an intermediate-range missile, enabling it to attack U.S. bases in Alaska, Guam, and Diego Garcia.[82] (Intermediate-range ballistic missiles can travel across a continent; ICBMs can cross oceans to reach other continents.)

The CIA's classification of the CSS-3 as an ICBM merits further discussion. The CSS-3 has a role in threatening the United States – Alaska and Guam are part of the United States. The CIA classification of the CSS-3 as an ICBM would apparently justify their inclusion in estimates of China's nuclear missile deterrent, commonly reported as 20-24 CSS-4 ICBMs. Estimates of China's nuclear deterrent as consisting of 20-24 CSS-4 ICBMs may understate the arsenal, since the estimates do not include China's 20 CSS-3s.[83]

The CIA report projects "Beijing could begin deploying the DF-31 follow-on ICBM and JL-2 SLBM in the last half of the decade."[84] The CIA estimate appears reasonable for the DF-31 follow-on, which has not been reported as having been tested. However, as the JL-2 has been tested, undergoing pop-up tests from a submarine, its deployment could appear sooner than suggested.

The CIA report claims China's "pursuit of a multiple RV capability for its mobile ICBMs and SLBMs would encounter significant technical hurdles and would be costly," giving an impression that the development of MIRVs for the DF-31 is unlikely or off into the future. But in January

[81] National Intelligence Council (CIA), Op. Cit., p. 9.
[82] Jack Spencer, Op. Cit., p. 24.
[83] Ibid., p. 24.
[84] National Intelligence Council (CIA), Op. Cit., p. 9.

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2002 China attempted a DF-31 MIRV flight test. While the test was inconclusive because the booster blew up in mid-flight, it shows that China has progressed on its MIRV program for the DF-31.[85] The CIA report appears to understate China's progress in MIRVs; neither does it suggest how the MIRV used for the DF-31 could presumably be used in its JL-2 derivative.

The CIA report, in addition, does not acknowledge the role China's intermediate range ballistic missiles may play in attacking U.S. forces in the Pacific, neglecting to explain, for example, how the CSS-3 was designed primarily to target U.S. bases in Guam.[86] The CIA report, moreover, does not describe China's development of non-nuclear warheads for electromagnetic pulse, attacks on runways, airfields, and hardened command posts, which would assist China in attacking other military forces and bases.

However, CIA National Intelligence Estimates may not always present the best intelligence. For example, the CIA's 1995 National Intelligence Estimate on ballistic missile threats excluded Alaska and Hawaii from its assessment, causing the State of Alaska in 1997 to adopt a resolution in protest, requesting that it be included in every National Intelligence Estimate.[87]

Another example: On August 24, 1998, General Henry Shelton, Chairman of the Joint Chiefs of Staff, wrote to Senator James Inhofe about the Rumsfeld Commission report on the ballistic missile threat to the United States, saying, "After carefully considering the portions of the report available to us, we remain confident that the Intelligence Community can provide the necessary warning of the indigenous development and deployment by a rogue state of an ICBM threat to the United States."[88] In addition, in response to the Rumsfeld Commission's finding "that rogue nations could acquire an ICBM capability in a short time, and that the Intelligence Community may not detect it," the general assured the Senator, "We view this as an unlikely development."[89]

Just one week later, on August 24, 1998, North Korea launched a

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[85] Ibid., p. 9.

[86] Jack Spencer, Op. Cit., p. 24. Major Mark A. Stokes, USAF, China's Strategic Modernization: Implications for the United States, Strategic Studies Institute, U.S. Army War College, September 1999, p. 87.

[87] Senate Joint Resolution 30, "Defense of Alaska from Nuclear Attack," adopted by the Alaska Senate on May 6, 1997 and the Alaska House on May 11, 1997.

[88] Letter from Henry H. Shelton, Chairman of the Joint Chiefs of Staff, to Senator James M. Inhofe, August 24, 1998.

[89] Ibid.

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three-stage ICBM, the Taepo Dong-1, that could reach the United States. This cast doubt on the ability of the Intelligence Community to provide timely warning of ballistic missile threats and developments.

The Current U.S. Direction Toward Ground-Based Missile Defense

It may be thought that China's ballistic missile buildup would affect U.S. military planning and its ballistic missile defense program, especially when the DF-31 is apparently intended for use against U.S. forces in the Pacific. The Bush administration, however, is continuing the ballistic missile defense program of the prior administration, which was focused on meeting the more limited ballistic missile threat from North Korea instead of the larger threat from China.

Rather than build the most effective defense possible, taking advantage of defenses such as the Brilliant Pebbles space-based interceptor and Space-Based Laser developed under his father's administration, President George W. Bush is continuing the Clinton administration's program for ground-based interceptors. In legislation adopted in 2001 for Fiscal Year 2002, for example, funding for the Space-Based Laser was cut from an administration request of $170 million to $50 million (the program had been well run – this was not a case of poor management, but apparently of political opposition to a space-based defense).[90] While this action was initiated by Congress as part of a compromise measure, it seems to show a lack of understanding of the advantages of a space-based defense.[91]

The failure to focus on building a space-based defense forfeits the numerous advantages a space-based defense has compared to a ground-based defense. A space-based defense, for example, can provide global coverage that could protect U.S. forces in Japan, Guam, Diego Garcia in the Indian Ocean, as well as in Hawaii and Alaska. It can provide a boost-phase interception capability, which would eliminate the potential threat posed by China's development of MIRVs, maneuverable warheads, reduced radar signatures, chaff, and decoys. A space-based defense will have more opportunities to intercept a missile, starting from the boost phase

[90] Jeremy Singer, "Pentagon Begins Dismantling Space Laser Program," Space News, January 7, 2002, p. 8. LockheedMartin, "DismantlingofIFX.doc," January 2002.

[91] Congressman Bob Schaffer, letter to Bob Stump, Chairman of the House Armed Services Committee, October 4, 2001; Congressional Record, Extension of Remarks, "Regarding the $400 Million Stripped from the Defense Authorization Bill," October 4, 2001; letter to Jerry Lewis, Chairman of the House Appropriations Subcommittee on Defense, December 13, 2001; letter to Secretary of Defense Donald Rumsfeld, December 13, 2001; letter to President George W. Bush (signed by other members of Congress), December 19, 2001.

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and continuing through the mid-course phase.

A ground-based ballistic missile defense, in contrast, will have less opportunity to intercept a ballistic missile. It will not provide global coverage; nor will it provide a boost phase interception capability except under rare circumstances. It will be less effective than a space-based defense at defending U.S. forces in the Pacific – the potential threat posed by China's DF-31 ICBM and its and short- and intermediate-range ballistic missiles. Yet President Bush is emphasizing deployment of a ground-based defense even though space-based defenses were shown to be feasible and effective under his father's administration.[92] Although in 2002 China's reaction to a U.S. ballistic missile defense has been muted, President Jiang Zemin has seemingly asked his generals to find weaknesses in the proposed U.S. ballistic missile defense. As noted by Willy Wo-Lap Lam in February 2002, it is believed China's response is focused on the development of multiple, independently targeted reentry vehicles – MIRVs -, which the CIA report appeared to understate.[93]

Conclusion

The United States needs to realize China is apparently engaged in a ballistic missile buildup that is aimed at the United States itself as well as at Taiwan. While China's number of long-range ballistic missiles may not equal the U.S. arsenal, the strategy it has adopted for their use is potent and aggressive. Its buildup, moreover, includes short- and intermediate-range ballistic missiles, which may have the potential for attacking U.S. forces in the Far East and Pacific. China's ballistic missile buildup should be expected to affect U.S. plans for a ballistic missile defense.

[92] Missile Defense Study Team, chaired by Ambassador Henry F. Cooper, Defending America: A Near – and Long-Term Plan to Deploy Missile Defenses (Washington, D.C.: The Heritage Foundation, 1995).

[93] Willy Wo-Lap Lam, "China Plays Waiting Game with U.S.," CNN.com, February 13, 2002.

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The Impact of Foreign Aid in Latin America

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The economic impact of foreign aid flows to Latin America (from 1974 to 1993) is examined empirically. Regressions are run to determine whether aid is invested or consumed and whether the consumption of foreign aid is reflected in indicators of human development (infant mortality, secondary school enrollment and life expectancy). However, no relationship is found between aid and improvements in human capital indicators. It is concluded that if continued aid to Latin America is to have a measurable economic impact a policy of selectivity (in the disbursement of aid) should be adopted. The merits of such a policy were recently acknowledged by the World Bank.

Key Words: Latin America, foreign aid, human development, infant mortality, life expectancy, World Bank.

Simply stated, foreign aid is an international transfer of capital, goods, or services for the benefit of other nations and their citizens. Whether foreign aid should be called a new phenomenon or not depends on one's point of view. In the history of diplomacy, subsidies and tributes have been common, and wartime aid among allies was already given by Britain during the eighteenth century and the Napoleonic wars, but peace-time economic aid among governments is novel. Generally speaking, the West has been involved in the economic development of the rest of the world since the time of the Discoveries. Yet, the use of public funds for the specific purpose of promoting and assisting in the economic development of other sovereign countries has no significant precedent before the Marshall plan. In the early days economic assistance moved a few hundred million dollars. Today, foreign aid is an industry of well over $50 billion a year.

Economic aid in its present form exists, allegedly, because there are great disparities of wealth between countries. But there is no general agreement that the primary objective of aid is the development of poor countries, and in some cases aid programs are supported on the grounds that they further the political and/or economic interests of the aid-granting countries or groups within these countries

One apparently simple reason for giving aid is promotion of export

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industries within an Aid-granting country. Developing countries sometimes appear to believe that this is the only reason. It is claimed that aid tied to exports introduces the country's products into new areas and opens new markets. It is sometimes argued that in the long run the prosperity of the rich and the poor countries is linked; that the development of the former depends on the expansion of the markets and production of the latter, and that this can be achieved by giving aid for the development of poor countries. Needless to say, there are important limitations to this line of thought. An increasingly prosperous Third World is obviously in the material interests of the rich nations, but first it needs to be scientifically ascertained that aid contributes to economic and social welfare, rather than merely asserted. As a spokesman for the Overseas Development Institute points out, "clearly the rich countries will benefit to some extent by an increase in the prosperity of the countries which are now poor, but to go on form there to argue that the rich countries, if they are concerned solely with their own prosperity, can promote their interests better by spending money on developing poor countries than by spending it in other ways, seems excessive (OECD, 102)."

The political objectives of aid may also be unconnected with the development of poor countries. Arguments for supporting aid on political grounds are often highly sophisticated. They involve linking of political objectives of donors with the economic development of recipients. Nonetheless, with the closure of the Cold War era the essence of these arguments has less obvious, although politics continues a powerful force in determining who gets aid. Alesina and Dollar (1998) find overwhelming statistical evidence that political and strategic alliances remain important in explaining the distribution of foreign aid across countries.

As a third broad category of reasons for foreign aid there is what might be termed as the "moral case." Giving aid seems to be largely an instinctive reaction. It is part of an observable phenomenon: a sense of universal solidarity has made remarkable progress in the last hundred years within the nations of the West, who now more or less accept that certain levels of poverty within a rich country are intolerable, and this feeling is being extended to the world as a whole. In this respect, the Word Bank's Michael Hoffman argues that: "this widening of our interests and concern is probably one of the major achievements of civilization...To stop now, to reverse the movement towards concern for the world as a whole, would be a retrograde step. It would mean a retreat into a larger mentality, self-centered and inbred (OECD 1967, 105)."

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Aid flows to Latin America from bilateral programs and multilateral institutions averaged about 13 percent of total global aid flows throughout the 1980s. This proportion has remained rather stable (OECD 1992).

The Economic Rationale of Aid

This paper does not seek to critique of the "nuts and bolts" of foreign aid, that is to say, the intricacies and practical problems encountered in the day-to-day of foreign assistance. These include the incompetence or corruption of the recipient governments, the complex machinery which has been developed for the transmission of aid, the all too common occurrence of perpetual delay in aid projects due to lack of commitment etc. Instead, this essay constitutes an attempt to test, in the context of Latin America, a popular economic rationale for giving foreign aid. This rationale says that aid fosters investment and economic growth in recipient countries. Regression equations constructed to capture any potential relationship between aid and investment and aid and consumption will be run in order to determine if there is such a relationship.

It may seem intuitively appealing that the world's rich community should give money to poorer countries, playing the likes of a catalyst for growth in these later countries. In 1946 economist Evsey Domar published an article on economic growth that postulated that GDP growth was proportional to the share of investment spending in GDP. The simplicity of the prediction made the Harrod-Domar model immensely popular. Eleven years later Domar himself disavowed his own model saying that it made no sense for long run growth and instead endorsed the new growth theory of Robert Solow (Easterly, 28). Regardless, development economists drew on Domar's original article. The conventional argument put forth to explain poor nations' continued and prolonged poverty was surprisingly simple: they suffer from a shortage of capital. Poor people, the argument went, cannot save much and thus poor countries cannot finance much-needed investment – precisely that which is needed for them to grow. As Nobel laureate economist Paul Samuelson put it, "They [backward nations] cannot get their heads above water because their production is so low that they can spare nothing for capital formation by which the standard of living could be raised (quoted in Bauer, 44)." The Harrod-Domar model was applied to poor countries to determine a "required" investment rate for a target growth rate. Foreign aid was seen as a way to meet the financing gap

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between a country's required investment and its own savings. Indeed, conventional wisdom assumed a rigid link from aid to investment to growth.

This overall explanation of underdevelopment was attacked on at least two grounds: first, it is not clear that all developing countries do indeed face a capital shortage; and second, low savings cannot be justified by average poverty since some of the poorest nations are home to some of the world's wealthiest elites.

What is clear is that the Harrod-Domar growth model exerted a strong influence in economics profession for decades. Foreign aid was seen by many as a sort of panacea to solve underdevelopment, even after decades of development experience suggested otherwise. As late as 1981, none other than Professor Hollis Chenery, then vice-President of the World Bank was to call foreign assistance "the central component of world development."

This paper is partially test of the "financing gap" argument but goes beyond it to test the effect of aid on indicators of social welfare. The implication of the Harrod-Domar model is inescapable: if foreign aid is to have its intended influence it should have a decided impact on investment. Attending to this logic, I shall undertake an empirical inquiry with the following structure:

(1) Test whether aid (F/Y) results in a statistically significant increase in investment (I/Y). Test concurrently for any significant correlation between consumption (C/Y) and aid.

(2) (a) If regression results establish that aid is spent on investment – to any meaningful degree – then foreign assistance will have withstood scrutiny.

(b) If, on the other hand, aid is mostly spent on consumption it will have failed the first test. However, consumption might be a goal in its own right if it meant the poorest were consuming more or if it reflected government expenditures or education, health services and the like.

(3) Measure the effect of foreign assistance on indicators of human development – especially infant mortality rates, secondary school enrollment and life expectancy – to determine whether this increased consumption is improving the lot of the poor and not that of the wealthy elite.

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(4) **Establish a conclusion** about the validity of foreign aid as it refers to its role in furthering social and economic development – based on results of tests (1), (2) and (3).

Regression Analysis

Overview of Data Sources

For the purposes of this paper Official Development Assistance data (ODA) will be heretofore called aid. This is data collected by the OECD and includes any transfer that has the objective of promoting economic development or welfare, has at least a 25% grant component, and is conducted through official channels. Therefore aid in the sense here used purposely excludes military assistance. Military aid is not relevant to this discussion since I am concerned with aid only insofar as it is said to contribute to economic and social development. Data on investment, consumption, GNP growth, and human development indicators comes from *World Bank Tables* (World Bank 1994).

The countries under study include twenty-some Latin American and Caribbean countries. Because of gaps in their data, the study excludes Antigua and Barbuda, Barbados, Belize, Guyana, Surinam, St.Lucia. The countries under study are (in alphabetical order): Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad, Uruguay and Venezuela – in all, a sample of twenty-one nations.

Representative Country Model

In order to elucidate the impact of foreign economic assistance on investment/ savings and on consumption, a model for a representative country shall be described in a world with a large number, K, of identical, small, aid-recipient countries. The empirical results will be based on estimating the following consumption and investment equations[2] with suitable instruments in time averaged data. The regression equations to be estimated are the following:

[2] These equations overlap largely with those encountered in Peter Boone's study: *Politics and the Effectiveness of Foreign Aid*, London School of Economics (1993). In this paper, Boone assesses the effectiveness of foreign aid programs so as to gain insights in the political regimes of recipient countries. His analytical framework shows how three stylized political/economic regimes labeled populist, rent seeking and laissez-faire would use foreign aid. He then tests reduced-form equations using data on nonmilitary aid flows to 96 countries. It is found that models of rent seeking political regimes best predict the impact of foreign aid and, moreover, that the impact of aid does not vary according to whether recipient governments are liberal democratic or highly repressive.

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$$C_{kt}/Y_{kt} = \bar{C}/\bar{Y}_k + ß^C F_{kt}/Y_{kt} + \delta_{kt} + \Omega_{kt} + t_t \quad (1)$$

$$I_{kt}/Y_{kt} = \bar{I}/\bar{Y}_k + ß^I F_{kt}/Y_{kt} - \delta_{kt} - \Omega_{kt} - t_t \quad (2)$$

where:

I/Y = investment as a fraction of Gross Domestic Product.

$I/\bar{Y}$= average investment to GDP ratio when foreign aid is zero.

C/Y= total consumption as a fraction of GDP

$C/\bar{Y}$= average consumption to GDP ration when aid transfers are zero.

$ß^I$=investment coefficient.

$ß^C$=consumption coefficient.

δkt=residual uncorrelated across countries.

Ω_{kt}=random country specific term.

t_t=time dummy

Equations (1) and (2) are not independent. The error terms are perfectly negatively correlated. This is because anything that affects consumption positively must affect investment negatively and vice-versa (C + I =Y).

The marginal propensity to consume from aid transfers will fall somewhere between 0 and 1; in mathematical notation: $0<ßc<1$. The same logic applies to marginal propensity to invest: $0<ßi<1$. If it is predicted that all aid will be consumed with no impact on growth, the null hypothesis is: Ho: ßc=1 and ßi=0. Regression results will be biased if aid flows are correlated with other capital inflows, or there is measurement error in the data. In any case, this can be tested by computing the sum of the two coefficients. If it is significantly different from one we will conclude that other financial inflows/outflows are associated with aid transfers and therefore our results will be biased.

The regression results will be based on pooled data covering ten-year averages from 1974 to 1983 and 1984 to 1993 using the ordinary least-squares method (OLS).

Sources of Bias and other Problems

SELECTION BIAS

It could well be argued that trying to measure the overall impact of aid across countries is grossly misleading. Since almost all poor countries have received aid it becomes a maddeningly complicated – if not unfeasible – task to know how differently they would have fared without it.

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Also, since some different countries may receive aid for predictably different reasons, it could legitimately be claimed that a cross-country study fails to take this into account making any results from the study effectively invalid.

Another type of selection bias might occur if the sample of countries under study include a disproportionate number of very low income per capita nations that are empirically known to have a tendency to consume – because conditions in these countries are particularly inimical to investment. This would tip the balance to the consumption coefficient to begin with. The same can be said for a study containing a sizable amount of countries undergoing permanent slow GNP growth. On the other hand, if donors made a habit of carefully selecting their aid recipients according to whether they had a history of implementing the sound policy, the opposite would occur and one should expect an overprediction of the investment coefficient. In practice, bilateral donors are mainly motivated by political considerations, not usually by a country's historical macroeconomic policy record. Multilateral aid, however, has a somewhat less political rationale.

Incidence Impact Bias:

Incidence impact biases would occur if the sample included less developed nations that changed the fiscal policies followed up to that point in response to the assistance given. Say, for instance, that Panama's government officials were genuinely concerned about the equalizing standards of living across the country and reducing disparities between rich and poor and thus commit to reducing distortionary taxes – an action encouraged by the added expenditures provided by the aid grants – when receiving aid. Such officials could be said to be part of a "welfare maximizing government." If the study included one or more such governments, then both the investment and consumption coefficients would be negatively affected. Another type of incidence bias could occur – and does in principle occur – in situations where aid is conditional on observable policy changes, specified by the donor country, that it is believed will lead to better growth prospects. If these changes are designed to promote investment, as they often are, then it is obvious which coefficient will be favorably affected.

Measurement Error

An important source of bias and one that I have made a point of

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avoiding is the often labeled "measurement error" bias. It occurs when a study includes countries whose aid inflows are so small in comparison to their overall economies (as a rule of thumb, accounting for roughly less than 0.50% of GNP) that aid could not conceivably have an impact on macroeconomic variables such as investment or consumption. The inclusion of these countries in the data to be regressed would underestimate both the consumption and investment coefficients. Thus, the study deliberately excludes from the full sample Argentina (0.08% of GNP comes from aid), Brazil (0.06%), Chile (0.28%), Colombia (0.24%), Mexico (0.10%), Uruguay (0.45%) and Venezuela (0.02%).

That is, seven economies and not coincidentally the seven largest ones.

EXAMPLES OF POSSIBLE BIASES IN REGRESSION RESULTS:

Selection Bias:	***Direction of Bias:***	
	β^c **[U. of 1]**	β^i
Donors give aid to countries with:		
1- low income per capita	+	-
2- slow growth	+	-
3- a proven policy record	-	+
Incidence Impact:		
1-Conditional aid leads to policy changes which promote investment	-	+
2- The incidence of aid depends on the mechanism by which it is allocated and types of allocation differ by donors	?	?
3- Welfare maximizing govts. will reduce distortionary taxes when they receive aid	-	-
Measurement Error		
1- Bias due to the inclusion of countries where aid is converging to zero	-	-

Aid and Fungibility

A second powerful objection may be leveled: aggregating aid flows is wrong since some types of aid may work better than others, but an overall analysis would not capture this. The reader can refer to work by Pack and Pack (1990), who conclude that aid money is highly Fungible. That is to say, governments that receive aid in one area can use

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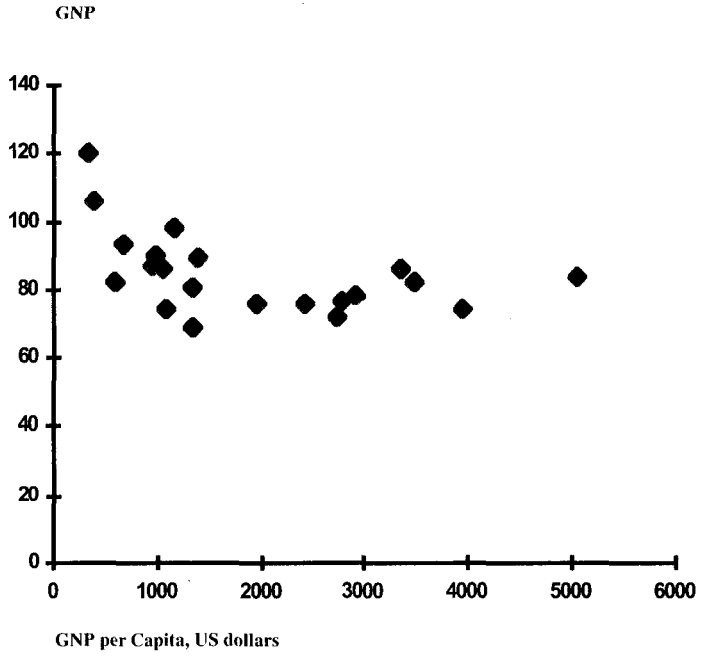
FIGURE 1: CONSUMPTION RATIO AND GNP PER CAPITA

Cons/ (21 Countries, 1984-93 averages)



elsewhere the money they would have otherwise have had to fund themselves. Therefore, studying overall flows is, in fact, a coherent approach. There is, however, an exception to this finding and that is for very small countries that receive large amounts of aid. This is the case for countries for which aid represents more than 15% of GDP. [3] At such high levels, it

[3] Pack and Pack (1993) test the fungibility of aid in the Dominican Republic and Indonesia. They conclude that aid was highly fungible in the Dominican Republic in the sense that one additional unit of aid expenditures did not lead to greater public expenditures in the areas where aid was targeted. By their own account, "these results are consistent with the most negative views on this question contained in the literature. The fungibility is characterized by major shifts from development expenditures to deficit reduction, debt services, and perhaps also to own-source revenue reduction." However, it would be inappropriate to generalize from this country's experience. As a matter of fact, it is found that in Indonesia, aid does "stimulate development expenditures, is spent on the purposes for which it is given, and has a positive effect on own

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appears that aid is no longer fungible since investment projects introduced by donors are no longer inframarginal. Because of this, there exists in these countries a very strong relationship between aid and investment levels. However, the correlation comes not from what aid achieves but from the transfer of resources itself. Extremely small countries have literally no option but to invest the flows. Only Nicaragua displays an aid to GDP ratio greater than .15, so it is excluded from the sample.

TABLE 1

DEPENDENT VARIABLE: TOTAL CONSUMPTION			
independent variable	*1974-1993*	*1974-1983*	*1984-1993*
Aid/GNP	1.46**. +	1.72**.+	1.18**.+
t-statistic	4.29	4.19	2.68
st.deviation	0.34	0.41	0.44
Constant	79.19	79.07	80.13
st. deviation	1.58	1.97	2.18
R2	43.4%	49.8%	51.3%
N	25	26	25

Null hypothesis: $\beta^{C} = 0$

**** Significant at 5% level**

+ Insignificant from 1 at 5% level

Empirical Results:

Consumption, Investment and Growth

Determination of Sample Size (N) The sample is composed of two data points per country drawn from the aforementioned Latin American group. The full sample would therefore include 42 points of data, that is, two from each of the twenty one nations – one for the 1974-1983 averaged aid to GNP ratio and the other for the averaged 1984-93 one. (Regressions covering 10-year timespans have the same size N because two five-year averages are taken per country). The base sample, however, does not include those whose Aid/GNP ratios are negligible. These are countries such as Mexico, Brazil or Venezuela for which foreign assistance accounts for such a minuscule part of their resources that it is effectively nonexistent and, therefore, could not realistically have any

revenues." This is because aid plays a bigger role in the overall Indonesian economy (about 4% of GNP), than in the Dominican Republic's (about 1% of GNP). The authors point out that "the more important foreign aid as a source of public revenues, the greater the ability of donors to monitor changes in expenditures and, therefore, the more likely are the recipient's expenditures to reflect donor intentions." This dictum should hold true for the countries under study here.

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meaningful effect on their consumption or investment propensities. Since there are seven such countries, this reduces the base sample to fourteen countries and twenty-eight data points. Nicaragua is an outlier (aid receipts are too high) and thus excluded. These steps result in a maximum possible data base of 26 observations. Some regressions include only 24 or 25 data points due to the outlier nature of particular data.

TABLE 2

DEPENDENT VARIABLE: INVESTMENT/GNP			
independent variable	1974-1993	1974-1983	1984-1993
Aid/GNP	-0.37**	-0.95	-0.06**
t-statistic	-1.15	-2.94	-0.35
st.deviation	0.32	0.32	0.18
Constant	22.62	24.82	19.61
st.deviation	1.37	1.22	1.46
R2	5.6%	26.5%	0.5%
N	25	26	25

Null Hypothesis: $\beta 1 = 0$
** Significant at 5% level

Consumption

The marginal propensity to consume from aid, standing at 1.46 for the twenty-year span from 1974 to 1993, is rather high, which can be attributed to the fact that the OLS estimates overpredict the impact of aid on consumption.

This is because the estimator does not purge the correlation between aid and income per capita. It is an empirically known fact that the poorer the country the higher its marginal propensity to consume (see figure 1 in Appendix) and therefore, if relatively more aid is given to poorer countries (see figure 2 in Appendix) then it follows that more aid is being given to countries with higher propensities to consume.

The marginal propensity to consume from aid during the 1974 to 1993 period is different from zero but no different from one for the specified thirteen countries. The second and third column in table 1 show that this result is robust across decades, with consumption propensities of 1.72 and 1.18 for the 1974-83 and 1984-93 timespans, respectively. The coefficient of correlation –the degree to which changes in the dependent variable (consumption) can be explained by changes in

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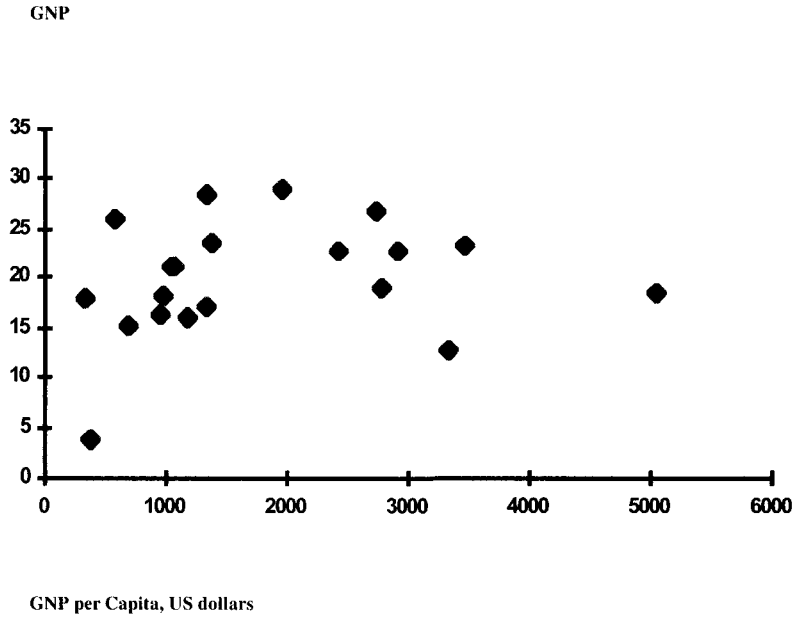
FIGURE 2: INVESTMENT RATIO AND GNP PER CAPITA

Con/ (21 countries, 1984-93 averages)



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the independent variable (aid) – is significant in all three regressions, hovering around 50 percent.

Investment

As was presumed, the marginal propensity to invest aid receipts is no different from zero. Interestingly enough, this result is not robust across decades, for the 1974-1983 coefficient defies predictions. As a matter of fact, the investment coefficient is a puzzling -0.95; that is to say, our regressions show a negative relationship between the amount of aid given and the sum of resources invested during that decade. This deviation from the expected coefficient results could be attributed to a number of causes. For instance, relatively more aid might have gone to countries with low incomes and/or low growth during this period. The coefficient for the period 1984-93 displays the expected lack of relationship between aid and investment.

All in all, aid is simply not invested in Latin American countries.

TABLE 3

DEPENDENT VARIABLE: GNP GROWTH RATE			
independent variable	1974-1993	1974-1983	1984-1993
Aid/GNP	-0.24**	-0.27**	-0.11**
t-statistic	-1.65	-1.07	-0.64
st. deviation	0.14	0.25	0.18
Constant	3.63	4.12	2.33
st.deviation	0.68	4.26	0.92
R2	11.0%	4.6%	1.8%
N	24	25	24

Null hypothesis: βGNP= 0
** Significant at 5% level

GNP Growth:

In light of the regression results obtained for investment, results in table 3 come as little surprise: aid flows to Latin American countries are found to have no bearing whatsoever on their economic growth. The growth coefficient for the entire twenty year period (1974 to 1993) is statistically no different from zero. This is consistent with the two 10-year sub-samples, with coefficients of -0.27 and -0.11 for 1974-83 and 1984-93 respectively.

These results are in roughly in line with what the Pearson Commission Report of the IBRD concluded already back in 1969 when it found that "the correlation between the amounts of aid received and the growth performance is very weak." Presumably nothing has changed since, given that this study comprises the

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1970's and 1980's.

In any case, economic growth should not be confused with economic development, a more inclusive term that includes qualitative improvements (upgrading of human capital, for instance) as well as quantitative gains in output. The present study is ultimately concerned with economic development and as such it does not come to a halt with empirical results for GNP growth. The study now seeks to gauge whether aid has influenced qualitative measures of development in Latin America.

Test for Bias in Regression Results

Results would be biased if there existed other capital inflows correlated with aid inflows – that is, if there were non-aid flows motivated by the giving of aid that take place concurrently. If the sum of the consumption and investment coefficients is significantly different from one statistically speaking then it can be concluded that the aforementioned flows do indeed exist and the results are biased. However, it is found that there is no correlation between aid and other capital flows, nor serious measurement errors.[4] Results are unbiased.

Empirical Results II:

Human Development Indicators

The second set of empirical tests seeks to determine whether governments used aid receipts to benefit the poor. Indicators that are widely available and are highly correlated with levels of poverty include infant mortality, life expectancy at birth, and secondary schooling ratios (primary schooling ratios are also often used). I therefore regress the logarithm of the difference between these indicators' 1974-1983 and 1984-1993 averages on Aid/GNP ratios. The logarithmic function is conventionally used when dealing with vital rates since, by their very nature, these rates take a long time to change.

---

[4] The null hypothesis will thus be:
H_0: $B^C+B^I=1$.
$t= (\beta^C+\beta^I) - (\beta^C+\beta^I)/ SE = (1.46+(-0.37))-1/ SE=1.09-1/ 0.74=1.21$
d.f.=n-1=25-2=23
$SE= \sqrt{Var(\beta^C+\beta^I)} = \sqrt{var(\beta^C+\beta^I+2cov\ (\beta^C,\beta^I)}$
β'=OLS estimator beta.
β=true beta.
$Cov\ (\beta^C+\beta^I)= E\ (\beta'^C-\beta^C)\ (\beta'^I-\beta^I)= (0.46)(-0.37)= -0.17$
$SE=\sqrt{(0.34)2+(0.32)2+2(-0.17)}= \sqrt{0.11+0.10+0.34}= \sqrt{0.55}= 0.74$
I will construct the standard 95% confidence interval and take $\alpha=0.05$. Then, $-t\alpha/2=-2.064$ and $t\alpha/2=+2.064$ are the values of t (the critical t values) for the 0.025 level of significance and n-2 df. The $100(1-\alpha)\%$ confidence interval is known as the region of acceptance and regions outside the interval are labeled regions of rejection or critical regions.
$t=1.21$ lies in the 95% region of acceptance ($-2.064 < t < +2.064$), thus we fail to reject H_0.
In conclusion, regression results are *not biased*.

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How has sample size been obtained in all three sets of "development indicator" regressions? From the initial twenty-one countries, seven have been excluded from the base sample because they are relatively large economies where aid looms minuscule.[5]

TABLE 4

DEP. VARIABLE: LIFE EXPECTANCY	
independent variable	1974-1993
Aid/GNP	0.05**
t-statistic	1.28
st.deviation	0.04
Constant	0.40
st.deviation	0.10
R2	12.9%
N	13

Null hypothesis: βLE= 0
** Significant at 5% level

Life Expectancy:

Expectancy of life at birth summarizes in a single number all of the natural and social stresses that operate upon individuals in a given society. For this very reason it is probably the most accurate measure of the quality of life in a given country. The number may range from less than 40 years of life in some of the most poorest nations to as much as 80 years for women in the most developed regions of the globe.

TABLE 5

DEP. VARIABLE: SEC. SCH. ENROLL	
Independent variable	1974-1993
Aid/GNP	-0.04**
t-statistic	-0.76
st.deviation	0.64
Constant	0.71
st.deviation	0.16
R2	4.9%
N	13

Null hypothesis: βSSE = 0
** Significant at 5% level

Table 4 shows that there is no connection between the general up-

[5] The six observations for low-spending governments are those governments that maintained spending ratios relative to GNP below the median. The same logic was followed to determine the governments under the "high-spending" label. Only the base sample countries have been included.

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ward trend in life expectancy observed in Latin American countries and foreign aid. The life expectancy coefficient stands at a negligible 0.05, statistically no different from zero. The logarithmic function has been used when determining changes from one decade to the next in life expectancy at birth averages, so as to render any relationship between this variable and foreign aid linear, instead of curvilinear. The results suggest that the longer lives enjoyed by Haitians, Peruvians or Salvadorans are entirely unrelated to foreign aid's success in ameliorating average health standards. Rather, they are due to sweeping worldwide improvements in medicine – in particular the eradication of once incurable diseases and the finding of vaccines for them

Secondary School Ratios

Assessing the number of schools in a less developed country translates into a task more complex than merely counting red-brick buildings with students in them. Often, resources of developing nations are such that only temporary or outdoor facilities can be afforded. Thus, according to UNESCO, a school is broadly defined as "a body of students organized to receive instruction." Data on education at the second level is based upon at least four years of previous instruction at first level. Why the choosing of "secondary school enrollment ratios" in the study as a measure of educational attainment? Because it is a more reliable figure than its chief 'rival' in vital statistics, literacy data (this latter usually given as a percentage of the population when it reaches 15 years of age). This is because standards as to what constitutes literacy differ markedly. Some countries take literacy to mean the ability to read and write; elsewhere it refers to the completion of a certain number of years in school; and other countries distinguish among degrees of functional literacy.

Again, the numbers here are in line with what this study has yielded so far. Education in Latin America is not becoming more widespread because of aid. Government officials are not using aid receipts to improve current educational levels or to make basic education available to a larger segment of the population.

Infant Mortality Rate

Out of the three human development indicators here presented, infant mortality will improve the quickest if the government invests in public health services targeted to the poor. However, aid fails in this department also.

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The infant mortality rate is calculated as the number of infant deaths (deaths of children under 12 months of age) occurring in a given year per 1000 live births. The importance of studying of infant mortality cannot be overstated if we consider the fact that in most underdeveloped countries one out of every five infants (sometimes more) dies before completing its first year of life. In fact, even in advanced countries, where conditions for infants are the best in the world, the first year of life remains the most vulnerable. Infants are highly sensitive to existing environmental conditions for their survival. In a majority of cases, the death of an infant is due to an insalubrious environment. Hence the infant mortality rate is generally taken to be a reliable and sensitive index of the overall health conditions of a country.

TABLE 6

DEP. VAR: MORTALITY RATE	
independent variable	1974-1993
Aid/GNP	-0.02**
t-statistic	-0.61
st.deviation	0.03
Constant	-1.16
st.deviation	0.08
R2	3.3%
N	13

Null hypothesis: βIMR = 0
** Significant at 5% level

Conclusion

The aim of this paper was to examine the empirical impact of foreign assistance on the consumption patterns of underdeveloped Latin American countries. A key prediction was that permanent transfers would be fully consumed. The empirical evidence presented here strongly upholds this view. For countries where aid represented more than 0.50% of GNP aid is fully consumed and nothing invested. Further, there was no statistical relationship between aid and economic growth.

An increase in the incentive to invest will lead to increased growth, savings and investment; yet, consumption may be claimed to be a goal in its own right if it betters the condition of the poor via improvements in

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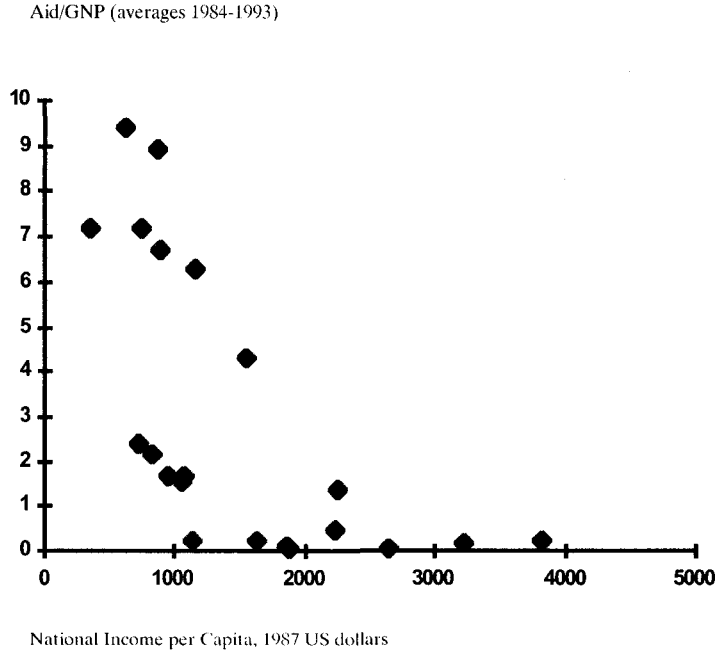
FIGURE 3: AID/GNP RATIO AND GROSS NATIONAL INCOME PER CAPITA



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health and education, for instance. A priori, if the poor benefited directly from foreign assistance they could invest in better education, sanitation and nutrition among others. Better conditions would translate into an increased political voice for the masses so as to further seize the benefits of aid and channel it in their direction. However, the opposite vicious circle seems to have taken hold, by which aid is not only managed by but also kept in the hands of the existing economic elite. Aid to Latin America is not contributing to the upgrading of its human capital.

While no test was run to find a possible negative relation between level of aid channeled to countries and their respective incomes per capita, the plotting of data on figure 3 – see Appendix – suggests that, in general, relatively more aid is indeed given to poorer nations. Similarly, figures 1 and 2 indicate that initially richer nations tend to invest more of their resources to begin with, and consume relatively more, than initially poorer ones.

Immediately the Cold War began, foreign aid became a big geopolitical business. But, politics aside, there was great optimism among development economists about the aid enterprise, given their almost blind faith in the aid-to-investment-to-growth formula. Perhaps the most relentless critic of the foreign aid enterprise from the very early days has been Peter Bauer, one of the fathers of development economics. As in a number of other issue areas in which he has swam against the current of his profession, time has vindicated his views. Lord Bauer raised a host of practical problems surrounding foreign aid, but the gist of his argument is crystal clear. This is what he writes:

> Foreign aid is demonstrably neither necessary nor sufficient to promote economic development in the so-called Third World... What has to be remembered and emphasized is that capital is the result of successful economic performance, not its precondition. Economic performance depends on personal, cultural and political factors, on social and political institutions. Where these are favorable, capital will be generated locally or attracted from abroad (Bauer, 41-46).

Economist Milton Friedman could also be counted among the handful of non-believers. He concluded, already back in 1958, that although the objective of foreign aid is commendable, the means to achieve it are misguided at best. In light of what is now know about foreign aid, his little-known essay Foreign Economic Aid: Means and Objectives, written in 1958, proves remarkably prescient:

> Additional capital is certainly essential for development. And of

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> course the more capital the better, *other things being equal*. But the way in which capital is provided will affect other things.
>
> ...The availability of resources at little or no cost to the country in question inevitably stimulates monument-building. Thus while foreign aid grants may in the first instance add to the capital available to a country, they also lead to a notable increase in the amount of capital devoted to economically wasteful projects.
>
> ...It will be well to consider the assertion that the underdeveloped countries are too poor to save and provide capital for themselves. Here, too, the alleged fact is most dubious. Currently developed countries were once underdeveloped. Whence came their capital? The key problem is not one of possibility but of incentive and of proper use (Friedman, 5-7).

The essence of Friedman's message is enclosed in the following paragraph. His thinking on foreign aid matches that of Lord Bauer.

> In short, if any generalization is valid, it is that the availability of capital while an important problem is a subsidiary one – if other conditions for economic development are ripe, capital will be readily available; if they are not, capital made available is very likely to be wasted (Friedman, 8).

In a real sense, it has taken the international development community forty years to officially come around this insight, if one takes the World Bank as the spokesman of officialdom. The 1998 World Bank report Assessing Aid, is frank about the poor historical record of development assistance and asserts that aid has led to increased economic growth only in those countries with good macro policy environments. This conclusion follows the pioneering study by Burnside and Dollar (1997). For the bulk of the development world, then, it has had no measurable positive effect. By the Bank's own estimation, aid could be four times more effective than it is today in terms of measurable social and economic indicators if a policy of selectivity in its disbursement were applied. Obvious political realities will always render the strict application of a policy of selectivity the stuff of fantasy, especially as concerns bilateral aid. But one can only hope that, in light of what is now known about aid effectiveness, rich-country aid budgets will be distributed somewhat more discriminately in the future. Only then will donors be able to truthfully say that foreign aid serves and achieves development goals.

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Appendix Human Development Indicators

	LIFE EXPECTANCY Years		MORTALITY RATE Per 1000 Births		SECONDARY SCHOOL ENROLLMENT RATIOS Percentage	
Country	1974-1983	1984-1993	1974-1983	1984-1993	1974-1983	1984-1993
BOL	52.4	58.1	117.0	85.5	33.0	35.3
COS	72.4	75.8	25.9	16.3	45.0	41.1
DOM	63.1	66.7	60.0	42.5	42.5	62.0
ECU	62.8	66.0	68.5	49.0	49.6	55.5
SAL	57.3	64.3	79.0	45.0	23.3	27.2
GUA	57.7	63.4	76.0	64.5	16.5	21.4
HAI	51.7	54.3	114.5	95.0	12.3	20.0
HON	59.8	64.9	74.3	53.0	24.4	34.5
JAM	70.7	73.0	22.0	15.5	60.0	61.0
NIC	58.4	64.5	75.5	58.5	33.2	40.7
PAN	70.1	72.4	29.0	22.0	61.1	59.4
PAR	66.2	67.0	50.8	38.2	25.2	29.7
PER	57.8	63.0	86.0	60.5	54.3	60.0
TRI	50.7	70.7	36.0	18.5	63.1	82.0

Source: World Bank Tables , World Bank 1994.

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THE DEBATE ON AIRLINE SUBSIDIES – I

The WTC Emergency Airline Subsidies

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Following the September 11 crashing of two airplanes into the World Trade Center (WTC) by terrorists, the US government adopted a large airline subsidy with the apparent goal of preserving essential airline services. However, economic analysis shows that it is unlikely to achieve this goal because it leaves marginal cost and marginal revenue unchanged. Thus, it is unlikely to affect the level of airline service and unlikely maintain airline employment. In essence there was a large transfer of money to the industry for very little, if any, public benefit. A very generous victim assistance program was also adopted. No rational reason can be found for a program that assists these victims more than those killed or injured in other disasters.

Keywords: Airline subsidies, World Trade Center, terrorsim, economic role of government, market as allocator, trade unions, market self-regulation, victim assistance.

Very quickly after the September 11 crashing of two airplanes into the World Trade Center (WTC) by terrorists, the US government approved a large airline subsidy as part of an emergency assistance act (Public Law 107-42). This was rushed through quickly with little analysis of what needed to be done or exactly what goals were to be accomplished. This article will apply some standard economic analysis to this hastily adopted program. If the points made below had been understood by Congress, it is very likely the program would not have been adopted.

Subsidies are frequently attacked because of an economic theory that predicts that in a free market the output levels chosen by firms will be the Pareto optimal ones. Customers are presumed to adjust their expenditures so that the marginal utility they derive from each commodity is proportional to the price of the good or services consumed. It is also argued that firms set their output levels so that price equals marginal cost. Under these assumptions subsidies reduce total economic welfare. The distortion of prices produced by subsidies reduces overall welfare.

While the above is standard economic theory for perfect competi-

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tion, the standard perfect competition model is inapplicable to the airline industry. It predicts that price will equal marginal cost. In turn, this implies that if marginal costs are equal, prices will be equal. This predicted price equality is absent. The airline industry is notorious for two passengers sitting in adjacent seats paying radically different prices. If one of these seats is priced at marginal cost, the other's price must differ from marginal cost. This is fairly clear evidence that the industry is oligopolistic.

Much of this pricing behavior arises from the difference between long run and short run marginal costs. The marginal cost of putting an extra passenger in an otherwise idle seat on a flight is quite low. This is why airlines are willing to sell seats they think would otherwise be empty for low prices. These are sold through discount mechanisms such as Internet sales, or with restriction designed to make them unattractive to business fliers (Saturday night stays).

However, if all seats were priced at such low levels, the fixed costs of flying the plane would not be covered and the airlines would constantly lose money. Hence the need to sell at least some seats at much higher rates, typically to businessmen.

The demand curve for seats on a particular route departing at a particular time has a rather steep slope. The airlines try to take advantage of this slope by charging high prices to those willing to pay them (typically business travelers) and lower prices to others.

The total area under the demand curve can be argued to give the total amount the consumers are willing to pay for access to that flight. However, the maximum revenue the airline can extract from the passengers is substantially less than the theoretical value of the service that particular flight offers. Leaving aside income distributional issues, this provides a well known theoretical argument for subsidizing airline services.

I mention the income distributional considerations because the average income of air travelers is quite high. Much of the high willingness to pay to get on a preferred flight arises because the business flier is willing to pay a large amount to avoid an hour's delay in getting to the destination (such as might happen if he had to wait for another flight).

This subsidy argument is likely to be especially important for small cities. Imagine a city pair where the profit-maximizing price was $200 and there were 50 passengers willing to pay this amount for a morning flight. Total revenue would be $10,000. Perhaps the most suitable

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plane would have 70 seats and cost $14,000 (including all cost, capital fuel etc.). Since total costs would exceed total revenue, offering service for this city pair would be unprofitable. However, the total willingness to pay of the passengers to pay to be on this particular flight may very well exceed the cost of flying it. The reason is that there may be individuals who are will to pay well above $200 to be on that particular flight. Especially if there are no alternative flights near the time of this flight and the city is isolated so that driving to another airport is hard; some of the passengers may be willing to pay well above the stated price for the flight. However, because raising the price to capture part of this willingness to pay would chase other passengers away, the airline provides less than the optimal level of capacity.

This argument is one that is frequently used to support subsidizing airline services. It is especially powerful when applied to isolated cities that can just barely support service. If that service is not provided, potential passengers do not merely wait a few minutes longer for another flight. Instead they may have to drive a long ways to get to their destinations (or, for islands, possibly even take a slow boat).In principle, there could be a small city that costs $14,000 to serve for which the total revenue is $13,500 at the profit maximizing fare. Yet the total willingness to pay of the potential passengers could exceed the costs. A subsidy as small as $501 could result in the airline providing service.

Conceivably, with the sharp downward shift in demand following the World Trade Center bombings some small cities could not have supported continued airline service. There is a case for subsidies to support continued service to such cities. The legislation did provide that adequate service was to be provided to cities that were being served on September 11. This was done by making continued service a requirement for the Federal aid.

A national defense argument for a large airline industry exists. In time of war, airplanes (especially transcontinental ones) are the normal method for transporting troops and supplying them. A major European or Asiatic war would require diverting planes to military service. The disruptive effect of this is diminished if the domestic fleet is large. In principle this argument could be used to support subsidizing the national aviation industry.

In cases where there is idle capacity that for some reason is not being used, the true resource cost of using that capacity is low. A subsidy that reduces the price of the commodity in temporary excess supply can increase efficiency. For instance, if the true marginal cost of a

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flight is only $50, but the price for some reason is frozen at $200, a subsidy that increases the number of people flying will bring some of this excess capacity into use and promote the general welfare.

The sudden shift in demand from the World Trade Center attack accompanied by a failure to lower prices did create a surplus of capacity. The failure to lower prices arose initially from an airline belief that holding sales would be perceived as inappropriate. The airlines probably also believed that passengers who were afraid to fly probably would not be lured back by a small decrease in fares. Of course, much of the inflexibility in airline fares can be explained by the reluctance (to say the least) of airline workers (like other workers) to accept cuts in pay.

Obviously, arguments for a subsidy as a way of using otherwise unused capacity can be met by the question of why not just cut prices, letting the loss be covered by the industry (and its workers) that has the excess capacity. However, regardless of the willingness of the airlines to cut fare, there was probably no feasible fare cut that would not have left the airlines with excess capacity and financial losses.

There are many counterarguments to the presumption that the resource inputs at the profit maximizing prices are optimal (Pareto optimal in the technical sense). At least in principle some of these arguments could justify a program of financial assistance to the airline industry. While many of the arguments would have been valid before the events of September 11, 2001, they might have even become stronger after those events.

The above arguments for a subsidy for the airline industry could be made for many other industries also. Many other industries can be argued to make a contribution to national defense and to hence to worthy of subsidy (and such arguments are routinely made for all sorts of industries).

The argument that demand curves for a particular product are sloping and that there is minimum total revenue that must be achieved if any of the product is to be provided is an argument that can apply to many other industries. There are probably many products for which the total amount consumers would be willing to pay exceeds the cost of providing them, but for which no feasible pricing system would result in them being provided. Subsidies for the industries providing these products might be justified by the same argument.

For instance, there may be drugs that are unprofitable to develop and sell because there is no price at which the total cost is covered.

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Yet it is easy to imagine there are some people who would pay much more than this profit-maximizing price if it would save their life. There could easily be other people who could not afford to purchase the drug at the profit maximizing price, and whose need for the drug is not reflected in the revenue that might be realized. This argument for subsidizing the drug business appears much more powerful than the argument for the airline industry.

If prices are above marginal cost for most industries, a subsidy to bring prices down to marginal cost for the airline industry may increase inefficiency in the economy rather than lower it.

Of course, recognizing that there are possible reasons for an airline subsidy program does not imply that the program adopted was optimal or even wise. To do this it is necessary to look at the program that was adopted and ask what its effects were likely to be.

The 2001 Subsidy Program

Shortly after the 2001 attacks (the legislation is dated September 22, 2001) Congress passed an emergency program (Public Law 107-42) that included a program of assistance for the airline industry. It granted sums of money to various airlines.

A stated goal of the program was to compensate the air carriers for the enforced shut down of the air transportation system during the crisis. It will be recalled that when it became apparent that multiple airlines had been hijacked and were being used as bombs, the US government decided to shut the air transport system down. No new departures were permitted and all airplanes were required to land. The fear was that there were hijackers on board flying planes, (or waiting for flights) and that tragedies might be prevented by this measure. With hindsight it appears all the hijackings planned had already been conducted by the time this decision was made. Of course, this decision was undertaken in a hurry with little information. It was not clear at the time what was going on.

A secondary goal of the shutdown was probably to identify any planes that might already be hijacked. Hijackers would be expected to ignore the instructions given them to land. A plane failing to land could be identified as one that was not under the control of the airlines' pilots. It is plausible that had any such planes been identified they might have been intercepted by fighters and forced down, or even shot down.

After the shutdown, there were several days when the airlines

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were forbidden to fly. This was undoubtedly expensive to them (and to the stranded passengers). Of course, there are hundred of government regulatory decisions that adversely affect various private interests and which are uncompensated. If the emergency actions had prevented any hijackings, the airlines would have benefited. At least one airline suspended takeoffs before ordered to do so by the government.

The bill also states that a goal was to provide compensation for other direct losses incurred by the airlines from September 11 to December 31, 2001 as a result of the attacks. This presumably included losses from fewer passengers and increased costs for security.

The compensation for this loss for the passenger carriers was to be divided evenly among the airlines in proportion to their available seat-miles in the previous month, subject to being limited to their actual losses. The maximum sum available was $4.5 billion. Cargo carriers were compensated by a similar formula based on available ton-miles with 500 million dollars available to them. Since this was a flat sum for which little had to be done, it should not be expected to affect airline future behavior (i.e. passenger service or employment).

In analyzing this program it is important to note the flat nature of the subsidies. The amount received by a particular airline was basically independent of the airline's decisions and their future level of operations. This makes it very likely that the scale and nature of the airline operations were little affected by the subsidy program.

The standard theory of how an industry selects its output is that it sets output at the level where marginal cost equal marginal revenue. In the context of the airline industry this would imply that an airline compares the revenue it would derive from a particular flight with the costs it would avoid from not operating that flight. The marginal cost of the flight differ from the total cost in that the marginal cost should not include the capital costs of the airplane, if this costs would have to be incurred anyhow or has already been incurred. Typically, these capital costs in the form of airplane lease payment, or the cost of the capital required to own the plane, will be the same regardless of whether the plane is operated or not operated.

The important thing to notice about the airline assistance program was that it changed neither the marginal cost nor the marginal revenue of operating any flights. It follows then that the airline assistance program should not be expected to change such parameters as the number of flights operated, the frequency of flights, the number of passengers carried, or the number of workers employed.

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This is a very important point. Many of the goals that an airline subsidy program might logically seek are not likely to be achieved by the program adopted. A case could be made for a program designed to keep essential airline services going. The program does provide an incentive to maintain services to small cities being served September 11 by making continued service to such cities a condition for receiving the subsidies. However, the sums of money given to particular airlines appear to bear no obvious relationship to the costs of maintaining such essential services, or to the subsidy needed to keep these services going (since passengers continued to fly and freight to be carried, the subsidy required to keep such services going would be much less than the total costs of the services).

The principal requirement was to maintain service to all cities served before the crisis. The cost of doing so appears to be far below the government aid offered. The way an airline accumulates large numbers of seat miles is by flying large planes over long distances (such as Boeing 747s from New York to Los Angles). Most of the money would go to the large trunk line carriers. Commuter carriers, flying small planes over shorter distances disproportionately serve the small cities whose service was threatened. The main program appears quite different from one that would be designed to maintain essential air service. There was authorized, in addition, $120,000,000 to maintain essential air services to smaller communities.

Many airline workers were laid off after the September 11 hijacking. There was much personal suffering. Yet the program does not appear designed to assist these people. Although one suspects many Congressmen who voted for the program were concerned about the welfare of the airline workers, on analysis the program does little to protect their jobs. (At most, a few flights to small cities might be continued as a result of the program when without it they would have been discontinued).

Admittedly, if the goal was to compensate for losses experienced (rather than to modify airline behavior in the future) the program adopted of giving flat sums based on available seat miles and cargo miles in a base period is at least simple to administer. Trying to determine actual losses and compensate them could consume vast numbers of man-hours. The time needed to determine the amounts to be paid in a more complex program could prevent prompt payment of money that might help keep the carriers out of bankruptcy.

On a between airlines equity viewpoint the programs appears to

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have two defects. One is that the cost of providing a seat mile is least on the long haul, high-density routes and greatest on the short haul routes. The program probably gave relatively too little money to the small commuter airlines. In the period of disruption after the crisis the added hassle of airline travel probably caused people to shift to buses and planes on short trips where these modes are only a little slower. This would not happen for long distance trips. It would take a lot of added hassle (safety inspections etc.) to persuade someone to drive across the US rather than to fly. However, on a trip of a couple of hundred miles or less the time required to drive is probably very close to that required to fly (allowing for the time needed to get to and from the airports). It is easy to imagine passengers shifting modes.

One airport, Reagan (formerly known as Washington National, and serving Washington, DC), was shut down much longer than other airports. The airport was closed for nearly a month after the September 11 attacks, and was not allowed to resume full service until the end of April of 2002 (Lewandowski, 2002). This was because the airport is right across the Potomac River from downtown Washington. It is very close to the potential targets in Washington DC. A plane could be hijacked from there and crashed in places such as the White House, US Capitol, Pentagon, or US State Department before anything could be done. Those who fly out of the airport know what a good view of these buildings a passenger gets. As a result carriers that served this airport, notably US Airways (the largest operator there), probably suffered more than other carriers. They were given no differential grants. Since US Airways is expected to apply for a loan guarantee, it may benefit this way. However, the loan guarantee program is much less generous than the grant program.

What does the grant program do? Essentially it transfers money from the Treasury to the airline. Who benefits from this money? It is the shareholders in the airlines and their debt holders. Which it is depends on whether the airline benefited would have filed for bankruptcy or not. Typically, in a bankruptcy (and theoretically always) the shareholders are wiped out. In cases, if any, where the airline would have filed for bankruptcy but for the aid program, the effect of the aid was to leave the shareholders with something. In addition, the debt holders get fully paid off. They benefit from the program to the extent the amount they are repaid exceeds what they would have received in a bankruptcy. In theory, the sum of the benefits to debt holders and

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stockholders will equal the government payment (plus any saving in legal and accounting fees from avoiding a bankruptcy). In other cases, where the airlines would have survived in any case, the company is worth more with the aid than it would otherwise be, and the stockholders can be thought of a receiving the full value of the government aid.

On average stockholders (and bondholders) are wealthy people and not ones we would normally be offering large grants to at the public expense. Admittedly, many of the shares in the airlines are held by pension funds of various types. However, the effect of high returns on a defined benefit pension fund is merely to reduce future contributions to the fund. This benefits the owners of the firm, not the employees.

The program probably could have been designed to increase service, although doing so would have taken time and thought. A subsidy of so much per passenger mile, per seat mile, or per plane mile would have increased the marginal revenue, or lowered the marginal cost. Either would have been expected to result in more flights. With more flights, more workers would have retained their jobs. Even if the subsidy was written as going to the airlines, faced with more otherwise empty seats the airlines would have been expected to lower fares. This would have benefited the traveling public.

Other subsidy schemes could have been invented. The government could have bought a certain number of seat from the airlines and made them available to government employees, military personal, students, the poor etc. This would have benefited the travelers as well as the airlines. Such a program would have probably placed a certain number of people on planes who otherwise would have still traveled, but would have done so by bus, train, or car. This would have hurt these industries. However, with other passengers shifting to alternative modes because of fear of flying, this would have freed up seats on the surface modes for those who were afraid to fly. Travelers who were willing to fly, and who would have flown but for the cost, would have benefited from such a subsidy.

One could imagine programs that made it possible for poor people to see relatives in other parts of the country that they had not seen in many years. Probably the most effective way to do this would have been by a subsidy of a certain number of cents per passenger mile, but one can imagine many other formulas. At some administrative cost, every person in the US could have been offered $100 off on an airline

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ticket to the destination of their choice. This could have had more people flying, and reduced the number of airline layoffs.

Probably the strongest claim for subsidies might have been to maintain service to small and isolated cities (such as Minot, North Dakota). If service had been completely lost to a small city forcing passengers to travel by another mode, the losses would have been large to those needing to travel to and from that city.

For large cities, the public losses from a decrease in service are relatively small. Imagine for convenience that traffic drops to half of what it had been on one route. The airline halves the frequency of flights. This doubles the average time between when a traveler would have preferred to leave and when he actually could leave. For instance, if there had been a flight every hour on a well-served route, the average time from the exact minute a passenger wanted to leave to the next flight would have been only half an hour. Shifting to flights every two hours raises the average delay to one hour, an increase of half an hour. If flights had been once every six hours on a thinly served route, shifting to once every twelve hours would raise the delay from three hours to six hours, an increase of three hours. Thus, the loss to the typical passenger in the thinly served airport would be six times as great as in the heavily served airport. While the actual loss to the passengers is less than the hours estimated above (most passengers can stay home longer or otherwise use the time between their ideal departure time and actual departure), the basic point that the loss arising from dropping flights is greatest on the less traveled routes remains valid.

A well-designed subsidy scheme would have aimed to maintain service on the less traveled city pairs. This might have been done by offering a certain number of dollars per flight for all flights between certain less traveled city pairs (limited to the number of flights that were scheduled to be flown before the crisis). If limited to city pairs that had less than four flights per day the cost might have been moderate.

In actuality the loss from reducing the schedule on the busiest city pairs is even less than indicated by the above argument. The busiest city pairs typically have a large city on at least one leg of a flight. The busiest airports are limited in the number of flights they can handle (frequently because of air traffic control limitations on the number of flights that can be handled per hour on a single runaway, combined with a limited number of runways). This leads to long delays as planes

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wait for their turns for takeoffs and landings. This wastes fuel as well as passenger time. A reduction in the number of flights will reduce the average delay time, and this will offset much of the loss from having to wait longer for a flight. US Airways improved their on time performance after the terrorist acts. This is probably due to less congestion at the airports it used, including Reagan.

As pointed out earlier the formula used for the subsidy directed most of the money to the long distance trunk airlines and very little to the short haul commuter airlines. Yet it is the commuter airlines that served most of the thinly traveled routes.

The government is also providing the airlines with loan guarantees totaling up to ten billion dollars. These will probably cost the government less than the grant program but raise very similar issues in that they transfer resources to the airline industry (i.e. its stockholders) from the taxpayer. However, if these guarantees make it easier for the airlines to borrow or reduce the cost of borrowing, they may encourage the airlines to invest more. This could result in more jobs and better service. Some of these jobs could be in the airplane manufacturing business or other capital goods industries.

So far only one airline, America West, has been granted a loan guarantee under this program. America West received a $380 million loan guarantee, which apparently permitted the company to receive a $429 million loan (the guarantee is for less than the full amount of the loan). In exchange, the government was given the opportunity to purchase nearly 19 million America West shares (about a third of the entire company) at a price of $3 each. That the stockholders gained is shown by the stock prices rising by 25.9%, to $3.11 when the deal was announced. It is hard to know exactly how valuable the warrants the government received were. The price of the stock was above the exercise price right after the guarantee was announced, showing that the government gained an asset (the warrant) worth something. The stock is now (April 19, 2002) at $5.12. This means that if the government exercised its warrants, and then sold the stock it would make over $40 million dollars. Obviously, this concession is of considerable value and reduces the net benefit to the airline from the guarantee. (The gain to the government represents money the stockholders would otherwise have). The government apparently obtained concessions from the unions and creditors as part of the process of negotiating the agreement.

Vanguard Airlines (a relatively small airline with only 13 aircraft)

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has applied for a guarantee. US Airways has announced it will apply for a guarantee. There may be others. It too early to know just what the impact of the guarantee program will be. The big question is whether the government will have to make good on the guarantees.

The government also assumed the terrorism liability risk in excess of $100,000,000 for a short period. To the extent that fear of terrorism liability deterred airlines from flying, this may have helped maintain service and employment. However, I suspect that very few airlines would really have decided not to offer a flight just because of the liability risk from a terrorist act. Remembering they have to be shown negligent before being liable, future lawsuits appear less likely. As a minimum, any one attempting similar seizure of planes to use as bombs would not have easy access to the cockpit. The flight crews have surely been instructed now not to let hijackers into the cockpit, even if they are threatening harm to the passengers or crew. Cockpit doors have been reinforced so that hijackers can not easily break through them (as they once could). The Federal government has taken over the management of the passenger screening before flights. One effect of this will be to eliminate lawsuits based on the airlines having been negligent in screening passengers.

In March of 2002, the Federal insurance was extended for another 60 days.

Bankruptcy

A major argument for the subsidy program is that some airlines might have to file for bankruptcy if they did not have government aid. For instance, US Airways testified they might have to file for bankruptcy without aid. To many members of the public the term bankruptcy calls to mind liquidation and a shut down of the airline. Admittedly, this is a possible outcome and several airlines did indeed go out of business. In the United States Midway (a small carrier) went out of business. In Europe Swissair and Sabena stopped flying. However, the likely outcome of a bankruptcy for most American airlines would be reorganization. The company continues in operation. The shareholders find the value of their stock wiped out, and the debtors have part of their debt replaced with an equity position. It is also possible that certain leases for airplanes and facilities would be abandoned. This is important because many airlines lease all or most of their planes. With a reduced level of business the airline would require fewer planes. The owners of these leased planes would suffer.

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The reorganized airlines would keep flying, although with a smaller numbers of flights and with fewer employees. A subsidy program was not needed to keep airplanes flying. However, this point may not have been understood by all who supported the program.

The Victim Assistance Program

One part of the airline assistance program benefited both the airlines and the victims. The victim assistance program provided benefits to the victims, but only if they agreed not to sue. They accepted the sum offered as a substitute for what they would have received from suing. This program brought benefits to both victims and the airlines. To determine accurately the split of benefits from this program would require knowing who might be able to bring lawsuits and how much they would win. Unfortunately, the outcome of the legal process is somewhat random. This makes it hard to establish the extent to which the program assisted airlines (i.e. their owners and creditors) rather than the victims. It should be noted however that to the extent that the victims would have received certain sums from a lawsuit, the airline should be credited as benefiting, not the victims. It is double counting if both the victims and the airlines are treated as having received the same sum of money. However, in understanding the political appeal of the program, it may have gotten support from both groups, and a politician may in talking to one group act as if all of the benefits went to that group.

Of course, to the extent that a lawsuit would have been need for the victims to receive similar sums, the lawyers would have received a large fraction (perhaps a third) of the benefit. Also, there might have been a delay of several years before the victims received anything from a lawsuit and this delay lowers the value of any eventual settlement to them. A widow faced with rearing children may prefer an immediate smaller sum when she needs the money to a larger sum received after the passage of several years. Also, the emotional strain of going through a lawsuit is high.

The law is clear that the people who were directly responsible for the losses owe damages to the victims. These people are the hijackers and those that assisted them. It is also clear that these logical targets for lawsuits are either dead, or have virtually no assets, or both. Mr. Bin Laden appears responsible (judging from some TV videos) and may even have assets, but it is not clear how to reach him to serve the summons, or where his assets are located. In any case, the perpetua-

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tors could not pay more than a small fraction of the damages a jury might award.

However, there are others that could be sued. For instance, the husband and children of a portfolio manager working in the World Trade Center have brought a large lawsuit against American Airlines claiming the airline could have prevented the hijacking. "The suit charges that American and its security service at Boston's Logan Airport, Globe Aviation Services Corp., were negligent in screening passengers, allowing hijackers to take control of Flight 11 and steer it into Tower One." (Hurtado 2002). Since such a lawsuit has been filed, American Airlines will have the expense of defending against a lawsuit and this expense may even be close to that they would have incurred from multiple lawsuits (which would have been consolidated).

Possibly the airlines could have prevented the hijackings, or they possibly could have prevented them from obtaining control of the plane. Doors could have been made stronger so hijackers could not enter the cockpit. Perhaps manuals should have made it clear that control of the plane was not to be given up, even at the cost of killing an intruder (who may be just deranged or drunk). Perhaps pilots should have been told to risk the passenger's safety by fighting anyone who entered the cockpit, even though in most previous hijackings the ultimate result was that the passengers survived. Perhaps cockpit crews should have been forbidden from leaving the cockpit. Of course, this implies that if passengers and stewardesses are being tortured to death that the cockpit crew is not to come to their assistance. It implies that an unruly drunk is to be allowed to create problems even if the cockpit crew could subdue him, or passengers and stewardess must subdue him.

Perhaps the devices that locate the planes for air controllers should have been designed so they could not be turned off from the cockpit. After all, there had been at least one case where hijackers had talked about running the plane into the Eiffel Tower in Paris, so the airlines should have been aware of the possibility of using planes as bombs. Perhaps the screening at the airports should have been better. Perhaps the post attack rules restricting box cutters, small knives, razors, etc. should have been imposed by the airlines earlier. Hindsight is wonderful, and a smart lawyer might convince a jury that the airlines could have prevented the hijackings, or at least the loss of life on the ground.

In considering the effects of this program on the airline industry,

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it is again necessary to remember that bankruptcy is not necessarily liquidation. Lawsuits take years to resolve during which time the airlines in question would continue to operate. If the airlines lost the cases, the judgment would be just another debt. Perhaps the worse outcome would be one where the airline found its access to credit markets disappearing because potential lenders were afraid that the claims of the victims would prevent the other creditors from being fully repaid. Possibly the airline faced with this problem would choose to file bankruptcy. The bankruptcy court would have to sort out the claims of the various creditors, which would include those who claimed to have been injured by its negligence. In this case the court could (and probably would) provide for new financing that would take priority over the older creditors (including the victims). This financing would permit the airline to keep flying, hence preserving its value to be used in paying the claims against it. The court would recognize the airline was worth more as an operating entity and could be expected to keep it flying. It follows that the lawsuit protection was not needed to keep the airlines flying.

In considering the problems that this outcome could create remember that only two airlines, American and United, were threatened with lawsuits. Even in the worse scenario, where one or both of these stopped flying, there would be plenty of other airlines to take over any services they abandoned.

Given that fear would lead to a decrease in total flying, the number of passengers to be accommodated in the event of an operations cessation by any single airline would be less than the number flying pre-crisis. Since all other airlines were similarly affected, other airlines would have a surplus of planes and crew to replace any discontinued flights, and there was not really an issue of maintaining essential public services. There appears to be no compelling public interest in preventing American Airlines and United from being sued by the victims that goes beyond preventing other lawsuits, such as those resulting from automobile crashes.

Of course, the other purpose of the victim assistance program is to assist victims. The program provides for payments to victims that are similar to those they would receive if they won a court case. Among other things they are designed to replace the income a breadwinner would have provided. This naturally means that the higher a person's income the higher the payments they receive.. In the outburst of sympathy for the victims (and appeals for funds) there was

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very little direct discussion of the fact that these appeared to be a relatively prosperous group of victims. Those on the airplanes would normally be expected to have the high incomes of those that fly.

Those who were in the twin towers were on average very well paid workers. The published occupations for most of the workers are things like bond trader (Cantor Fitzgerald, a bond trading firms was the employer of the largest number of WTC workers killed), investment manager (Fred Alger Management Inc was hard hit), banker, broker, etc. which are known to draw very high salaries (usually supplemented by large bonuses). The twin towers were occupied by such firms as the Bank of America Corp., Kemper Insurance, Lehman Brothers Holdings Inc., Credit Suisse First Boston and Sun Microsystems Inc. The brokerage firm Morgan Stanley Dean Witter was the World Trade Center's largest tenant.[2]

The World Trade Center was premium office space, with many offices offering a view, and commanding premium rental rates. Firms normally rent such space only for their highly paid employees and immediate support staff (their secretaries and receptionists, for instance). Frequently financial service firms rent space in a lower rent area for their "back office" processing functions, which have large number of moderately paid clerical workers. While there were certainly some lower paid workers (restaurant workers, cleaners, security guards, and firemen) the victims do appear to be well above average in income and wealth.

Paradoxically, the high status of those injured may have helping in getting them aid. The very influential New York media people and other members of the establishment often knew victims. It is easier to feel sympathy for those you know than for those who are merely names in another part of the country.

From a public policy viewpoint it is hard to provide a rationale for aid to these victims while victims of many other disasters are left dependent on private resources and charity. In addition to Federal aid, many victims received very generous aid from private charities. The Red Cross alone raised nearly $500 million to help the victims of the Sept. 11 terrorist attacks. The Red Cross had trouble finding enough victims to give the money they raised to. Even with no federal aid, the victims would have suffered less than the typical victims of disasters.

Outside of this program the Federal government provided for re-

[2] See http://www.thestandard.com/article/0,1902,28955,00.html

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funds of income taxes paid by the victims of terrorism in this year and in the previous year, with a provision that a minimum of $10,000 be provided to the family of each victim. It also shielded the first 8.5 million dollars of victim's estate from the estate tax. The government victim's web site estimates the estate taxes that would have been paid by someone leaving an estate of $8,000,000 to be $3,047,050 and notes that this would not be owed by a WTC victim's estate (see http://www.usdoj.gov/victimcompensation/faq5.pdf).

In terms of tax policy it is hard to make a rational case for these provisions. Why should two (otherwise identical) rich individual's heirs be treated differently just because one died in this disaster and another died in different type of disaster?

In understanding the politics here, it should be realized that different committees handle tax matters and transportation matters. If a cause is popular (as aiding the victims was) each committee desires to do something. The total aid may be greater than would have been adopted if a single committee had designed the whole program. With two programs designed separately (and under time pressure), coordination will be poor, or zero.

The program aims to reimburse for all economic losses (such as lost wages for those killed and medical expenses for those injured (for a description see http://www.usdoj.gov/victimcompensation/faq5.pdf). The lost wages are based on earnings for the last three years and incorporate expected wage increases, including those resulting from younger workers being promoted or moving to better paying jobs, as well as the increases that occur reflecting inflation and growth in the economy. The number of years a worker would work is estimated using data for males. The use of male data benefits females. Females typically quit working earlier or cease working for family obligations. There is a deduction for the deceased's expected living expenses and for taxes he would have paid. The difference is to be discounted at rates based on Federal bond rates. This formula would be used for worker earning up to $231,000 (which covers 98% of the US workforce). Higher paid workers (of which I am certain there are many) would be handled on a case-by-case basis. The special master claims the rules were designed to be on the generous side (as one would be expected of a program designed by one who hears complaints from those who did not get what they wanted, but does not hear from the taxpayers who pay for it). The program gives for non-economic losses $250,000 to each spouse, and for each other dependent $100,000

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(Associated Press 2002). The average pay out per person was to be $1.85 Million (Associated Press 2002).It will probably be even higher when the case by case determinations are made for the highest paid workers. The total benefits are reduced for life insurance and similar benefits. However, they will not be subject to Federal income taxation.

Certainly sums this large would be of great use to the families of many others who happen to die, perhaps in very similar circumstances. It has been frequently pointed out that the victims of the Oklahoma City bombing did not receive government benefits of this magnitude. The families of the soldiers who are killed in war (even the Afghanistan war that resulted from the WTC attack) do not receive such generous benefits. Firemen and policemen killed in other incidents (even those where they deliberately risked their lives to help the public) do not receive as much aid. While in many cases the beneficiaries were dependents (spouses and children), there are undoubtedly many cases where the closest relative suffered no real economic loss (say a brother or parents in another state) and perhaps very little emotional loss (say the closest relative was still a very distant relative). One might also question the public policy wisdom of penalizing those who had taken out life insurance by reducing their benefits by the amounts they received.

In addition, many of the victims received benefits from charities. These amounts were very large and it appears the Red Cross and other agencies had collected more money (even on a per capita basis) than had been collected for other disasters. The Federal government gave additional assistance by forgiving income taxes. New Jersey put in a special college scholarship program for the children of victims. There was indeed a great outpouring of compassion.

Admittedly those receiving aid were required to give up their right to sue. They also had their benefits reduced for other sources of aid they would have received such a life insurance and social security. It is hard to know how much these people's right to sue that they gave up was worth. It is far from clear that the building owners or airlines were negligent and a court case could easily have brought them nothing. It is clear, that much of the proceeds of any lawsuit would have been consumed by lawyer's fees and that it might have been years before the beneficiaries actually received anything. There would have been an emotional toil in going through a lawsuit. It is also clear that the defendants in any suits would have had high lawyers' fees. The government in reduced corporate income taxes would have paid part of these fees.

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It not clear what distinguishes the trade centre destruction from the many other instances where a person dies or is injured, and the WTC case promotes reflection on such other instances. Every fatal automobile accident leaves victims. The state does not currently offer them payments in lieu of their right to sue. Large savings could be made in legal costs if victims were automatically compensated without an expensive trial. Indeed, there has been much discussion of the case for no-fault automobile insurance. Even then, it was expected that those benefiting from the insurance would pay for it. It is virtually certain that the average automobile victim is much poorer than the victims of the World Trade Center attacks.

The explanation for the program must lie in the political advantage of a program that appeared to aid both the airlines and the victims. Even then, it probably took an environment where the politicians were under pressure to do something. Because the victims were typically well off-educated New Yorkers and were known to opinion leaders in the media and elsewhere, it was possible to adopt a program that gave money to corporations and wealthy individuals. Many have noted that the Oklahoma City bombing did not result in any similar aid program for the victims. I suspect had the attack hit any other areas than Manhattan and Washington, the same number of causalities would not have resulted in a program comparable to the one that was adopted.

Conclusion

With even a little economic analysis the emergency program to aid the airlines adopted after the events of September 11, 2001 appears to be inconsistent with widely accepted ideas of equity and efficiency. It appears to be a program that did little to maintain essential services and assisted well off individuals rather than the poorer ones.

It is likely that if the legislation had been delayed for a few months and discussed it would not have been adopted. As it was rushed through without much thought, this shows the problem of legislating in a crisis mode.

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THE DEBATE ON AIRLINE SUBSIDIES – 2

Should Airlines be Subsidized in an Emergency? The Libertarian View

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The authors apply the theory of an unhampered market economy to the post-September 11 situation of the airlines in the United States, and argue that a government bailout ill-serves the market, misdirecting resources and retarding a consumer-driven adjustment of supply and demand to reflect the new realities of the marketplace.

Key Words: Airline bailout, economic role of government, market as allocator, entrepreneurial function, effects of government economic intervention, bailouts and employment, trade unions and the airline bailout, market self-regulation.

I. Introduction

Demand for air travel is down in the U.S., and we must ask whether the U.S. government is not giving billions of dollars to an industry that consumers no longer wish to support at previous levels?

The arguments given in favor of the post-September 11 bailout focus on different issues, but the underlying theme in each of them is that there is a role for government to insure the viability of the American economy. Those, like the present authors, who oppose this viewpoint hold that the market itself plays precisely this role through the forces of competition and the allocation mechanisms of price and profit. They maintain that the most important element in the market is the entrepreneur who works to correct any lack of coordination through his self-interested profit-seeking. In taking money away from those who perform this function and giving it to the airlines, politicians disrupt the very economy they are supposedly trying to save. In this article we will consider and several of the most prevalent arguments made in favor of government's subsidizing the airline industry.

1. Unexpected attack

The first argument in favor of subsidies in the present circumstances is that the terrorist attacks on September 11 were an unexpected occurrence. John S. Irons says, "...The events of the past week were an unexpected occurrence and had nothing to do with the fundamental viability of the industry (Irons, p. 1)."

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It goes without saying that the attacks on the World Trade Center and the Pentagon were unexpected. In fact, this was so much so that consumers were unaware of this particular risk associated with flying. However, to argue that surprise events are a reason to subsidize the industry is inherently contradictory. It is impossible to separate the events that happen in an industry from the industry itself. Buyers and sellers are constantly evaluating the costs and benefits of a transaction and thus making decisions that are mutually beneficial. When contracting parties are made aware of a new cost or risk, the parameters of the entire transaction are bound to change.

Ludwig Lachmann stated, "value is not a property inherent in goods, but constitutes a relationship between an appraising mind and the object appraised (Lachman, p. 95)."Using his view of the nature of value, we can see that air travel does not hold a specific value outside of the realm of the person who is (or is not) buying the ticket. Thus, the measurement of this value is subject to change when the perceptions or expectations of that person change (Littlechild, p. 13).That is precisely what happened when terrorists boarded four planes with the express purpose of using them as bombs. Consumers were made aware of the fact that terrorists could and would use commercial airplanes in this way. They could no longer ignore a new and substantial risk of flying in an airplane. The cost and value of air travel has changed. This is evident from the decrease in demand at the same time there has been a significant reduction of ticket prices.[1]

To bring ticket sales back to the level they were before September 11, ticket prices must fall by an amount comparable to that by which the implicit costs increased, ceteris paribus. Thus, although the events of September 11 were unexpected and had nothing to do with the industry before that date, they intimately affected the viability of the industry afterward. That unexpected events caused a change in the cost of air travel will not change that fact. It is neither just nor practical to make consumers pay for something that they obviously no longer want, certainly not to the same degree as before.

2. Centrality of Air Travel

The argument is made that the airline industry is a vital part of the economy and that we should not allow it to fail. Consider the claim

[1]The decrease in ticket prices is a direct result of a downward shift in the demand curve for air travel. As the implicit cost of air travel increases, namely the risk of being in a flying bomb, demand must decrease for all prices along the demand curve.

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made by Continental Airlines CEO Gordon Bethune, who said, "You're not going to live without this vital part. We are not some machine, some computer. We're a pump just like the heart's a pump, and we need to facilitate and keep our economy going" (cnn.com, ailing airlines, p. 1).

This appeal claims that if the airline industry is allowed to flounder, then the economy will die just as the body dies when the heart stops. Again, we come to a basic error. It is assumed that the economy before September 11 is the same as after September 11.It is true that such swift changes in the nature of our economy are uncommon; but that does not mean that they do not happen. It also does not imply that we should try to restore the economy to its previous state (Hazlitt).The market is in a continuous state of change; when left alone it continuously finds better means of producing more and better goods.[2] If the value of air travel no longer justifies the cost, why do we assume that it is still a vital part of our economy? It is far more accurate to say that it was a vital part of our economy in the past and that we don't know what role it will play in the future. The market coordinates the allocation of resources to the most highly valued goods and services. It does this through prices and it is obvious from cheaper tickets, and fewer of them purchased, that air travel is not as highly valued as it once was, thus not as vital.

By giving the airlines billions of dollars, the government takes resources away from individuals who would spend the money in other ways and forces them to spend it on airlines. Without this forced investment, consumers would use their income on their highest alternative. Maybe it would be the railroads, or rental cars or dinner and a movie in their hometowns, but the resources would go to the industry that consumers value more than airlines. The billions of other people's dollars that the bureaucrats are so generously giving the airline industry is nothing more than a transfer of wealth from taxpayers, and the other industries that they would have voluntarily supported, to the air carriers and their stockholders. The airline industry will benefit only at the expense of other industries (Hazlitt, p. 101).

At one time in American economic history, the horse and buggy industry was riding high. It, too, was "vital" to the national prosperity. Apart from railroads, bicycles and skates, foot power was virtually the only way to move from one place to another. With the "logic" of the vi-

[2] The mainstream view treats the market as a mechanism by which given goods are produced with given techniques while Littlechild sees the market as an organism that unintentionally creates new goods and techniques by way of individuals seeking profit (Littlechild).

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tal industry argument, horses and buggies, too, should have been subsidized.[3] But had the American government followed the subsidy policy that is now being widely advocated for airlines, the effect would have, instead of improving the economy, given it a severe case of arteriosclerosis. According to the doctrine of alternative or opportunity costs, industries can only be subsidized into (continued) existence at the cost of eliminating others. Would we really be better off with horses and buggies and typewriters at the expense of eliminating cars and computers? Hardly.

3. Help the workers

Proponents of the bailout demand subsidies if not for the airlines themselves then for their employees. But this claim, too, is suspect. First of all, it is doubtful that a government subsidy of the airlines will save jobs. As Steven E. Landsburg points out in his article, "Flying Pork Barrels," "Airplanes are flown when it is profitable to fly them, and they are not flown when it is not profitable to fly them. Giving cash to the airlines does not change the profitability of any given flight, so it does not affect any decision about which flights to offer" (Landsburg, p. 1).

In fact, what does influence decisions to fly planes is directly related to demand. With the downward shift in demand, prices are lower as well as the quantity consumed. Profitability of flights has been greatly reduced; thus, airlines are flying fewer routes. With fewer routes to fly, airlines need fewer employees, who will be laid off if demand remains poor. Giving money to the airlines will not change these facts. In fact, some proponents of the bailouts recognize the dilemma and consider it to be a solution for "explicit and enforceable job pledges to ...be built into an air-industry rescue (Donahue, p. 3).[4]"

The problem is that this proposition looks only at the short-run effects as they relate to one group and forgets about the long-run effects on the economy as a whole or even the short-run effects on other groups (Hazlitt, p. 18). Including a clause to ensure employment simply extends the subsidy to the airline employees without solving the problem. It is a direct transfer of wealth from the taxpayers to the airline employees. The transfer is at the expense of the workers in the other industries in

[3] And this goes, as well, for other now extinct or virtually extinct firms, such as typewriters, hula-hoops, candles, etc. Farming used to account for almost our entire employment; now, only a small fraction of the labor for works in this area.

[4] John D. Donahue argues for the bailout by comparing it to the Chrysler bailout. Further arguments from his analysis will be discussed later.

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which people would have spent their money and is thus harmful to the economy. If labor is being employed for reasons other than productivity, then capital resources are being kept from industries where they would be most productive. This applies, also, to human resources. Can we really rationalize keeping thousands of people in jobs where they are not needed? It is a harsh fact that the terrorist attacks affected so many people, but keeping workers in jobs where they are not needed helps them only in the short-run at the expense of other people who will not be able to get jobs. In the long run it lowers the standard of living for everyone.[5]

Nor can we ignore the fact that "At big airlines, senior pilots make in excess of $200,000 annually" (Samuelson, 2001).Other salaries in this industry are similarly inflated above market levels. A large part of the bailout to the airlines, then, is really a subsidy to these radically-overpaid employees. That this is but further evidence of the problematic nature of this government plan is not at all an indication of greed, envy, egalitarianism or any other such sentiment. Rather, it stems from opposition to yet another government interference with markets: compulsory unionism. Were it not for such violations of the free society as the Wagner and the Taft-Hartley Acts, it is unlikely that workers' organizations would have been strong enough to compel such stratospheric wage rates (Block, 1991).That the airlines were forced to pay them is responsible for their parlous condition before 9/11/01, and continues to be an obstacle to any rational restructuring of the industry. A bailout would only validate these excessive wages. Without it, either unions would consent to a radical lowering of the salary structure, or, like parasites on a host, they would kill the airlines who consented to these contracts and their place would be taken by firms who could more strongly hold the line against them.

4. Adjustment costs

Another argument for saving the airline industry comes from John Donahue in his article, "Airline Package Harks Back to Chrysler Bailout. "Donahue supports the bailout on the grounds that "airline turmoil threatens consequences beyond the carrier's balance sheets" and that "a complete air-travel meltdown could have grim, far-reaching consequences (p. 2)."

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[5] Hazlitt (p. x) states that by forcing people to subsidize employees of any industry, government is keeping them from spending the money in other industries, thus preventing additional employment in those industries.

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He implores us to remember the lessons learned in the Chrysler bailout, but he seems to have forgotten them himself. Donahue points out that "bankruptcy isn't oblivion (p. 2)" and he is absolutely right. In fact, this counts against the very point he is making. If bankruptcy does not mean a complete loss of capacity, then what is the argument for saving the airlines in light of the fact that they could simply reorganize under Chapter Eleven? The answer given by Donahue is that adjustment costs should be minimized. The task then becomes to ask: where do adjustment costs come from? If the airline industry went through a momentary slump and the major firms had to reorganize only to come back to the same level of capacity after some time and much effort, then there would be an argument that adjustment costs could possibly outweigh the cost of the bailout. Donahue, indeed, argues that this would be the case (p. 2).

But his argument rests on a false assumption. It posits that anyone, much less bureaucrats, can have the information necessary to determine what the adjustment costs would be. But this is unfounded and is unproven even by the proponents of welfare economics (Hayek, 1948).Furthermore, the adjustment costs would presumably be unjustified if the industry returned relatively quickly to its original state, and that is again an impossible forecast. Without such knowledge, government cannot be expected to make accurate decisions that are in the best interest of the economy. The market will work to minimize adjustment costs through the self-interest of each individual participant.

5. Promoting competition

A most disturbing argument favoring the bailout is that it is an opportunity to create more competition in the airline industry. Thomas (2001) states that the bailout should include provisions that carriers reduce their dominance of particular airports. Citing figures from the Consumer Federation of America, he claims that prices would be reduced by 20% to 50% (p. 2)[6]. The problem is that each airport is treated as an individual unit. Different airlines have dominance at different airports, however, as Thomas himself points out,

> Every flier knows which carrier "owns" which airport: US Airways in Charlotte and Pittsburgh; Delta in Atlanta; American in Miami and Dallas-Fort Worth; United in Denver; Northwest in Detroit; Conti-

[6] It is interesting that Thomas does not state that the Consumer Federation of America's figures had anything to do with airports specifically. He also uses the phrase "competitive markets" without defining it.

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nental in Houston"(p. 1).[7]

This being the case, airlines are still competing. It does not cost more to fly from Denver on United simply because that airline has a large share of the gates at this airport. In fact, it may cost less to fly directly to Denver on United than it does on airlines that are not based there, because this allows a direct flight.

A subtler and indeed more dangerous point is that government intervention is the solution to perceived market failures (Hummel). The idea that the state is required to solve problems in the market does not recognize the self-regulating mechanism of the latter. Lack of coordination in the market, as shown by shortages or an opportunity to profit, is alleviated through the actions of the profit-seeking entrepreneur who looks for opportunities to fill a consumer need. If, indeed, prices could be cut by 20% to 50% with no negative repercussions on the company, this would imply that the airlines were earning 20% to 50% percent more profits than they would if there were "competition." If so, the profits being earned by the existing firms would draw more business concerns into the industry until those non-equilibrium gains were competed away (Littlechild, p. 23).

Can it properly be claimed that the airline industry has high enough start-up costs and great enough economies of scale that entry into the field is restricted, meaning that smaller new firms that want to compete with larger established firms would not have the means to do so? Not at all. One need only look to Southwest Airlines, which entered the market not long ago and has been the only firm to earn a profit in recent history. Interestingly enough, Southwest achieved this through low costs rather than high prices. Further, and more basically, this argument is fallacious. If in the eyes of potential investors profits are to be made by entering the industry, the so-called "barriers to entry" can be overcome through the aggregation of capital via the stock market. In any case, these "barriers" emanate not from any "market failure," but from the economic fact that the investment phase of some start-ups (e.g., the airlines) is more substantial than that of others (e.g., the shoe-shine business).

Thomas remarks, "any federal bailout of private business... moves

[7] It is also notable that Thomas is associated with the University of Pennsylvania, located near Pittsburgh that is one of the airports owned by US Airways that has announced cutbacks. Thomas uses this as an example of why dominance at airports is harmful but he omits the fact that nearly all of the above mentioned airlines are also announcing cutbacks, so presumably all of the airports would be hurting regardless of dominance.

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us further away from capitalism (p. 3)."He is correct; but then he concludes the statement by saying that the action must have a "redeeming feature that ultimately makes the markets work better (p. 3)." In doing so, he contradicts himself.[8] Any government intervention moves us farther away from a free market where resources are allocated according to demand, and there is no exception for a "redeeming feature."

The second problem with such government intervention in the market is the problem of how to make the decisions on what is to be done. We have already spoken about the impossibility of government's having the necessary information to make these decisions with any degree of accuracy. The Air Transportation Board was established by the United States Congress to gather information and decide how to allocate the relief funds (Zuckerman, p. 1).David M. Walker said in his interview with Laurence Zuckerman, "It's clear that the Board will have a considerable amount of discretion (p. 1)."That is, the Board will decide which airlines are eligible to receive the government-guaranteed loans. As thirteen senators wrote to Mitch E. Daniels, this will "put the government in the position of deciding which airlines are worthy of existing and which are not (Zuckerman, p. 3)."However, if the Board decides to allow the loans to be open to all airlines, it will be supporting those that were in financial trouble even before September 11 (Zuckerman, p. 3).It is hopelessly naïve to believe that politics will not play heavily into any decisions that the Board makes.[9]

In spending billions of dollars to insure the survival of the airline industry, the federal government made two grave errors. One, it assumed that it had the knowledge required to determine the best use of taxpayers' money. In doing so, the state has robbed both citizens and the industries they would otherwise have patronized. At the root of every argument in favor of the government bailout of the airline industry is the view that government is more capable of making decisions about what individuals should spend their money on than the individual who has earned the money. Paternalism is a dangerous thing and is indeed incompatible with the idea of a democracy. To assume that adults need someone else to make their decisions for them and then to turn around

[8] Thomas invokes Adam Smith's "invisible hand" in this statement implying that the forced divestiture is an example of this simply because it will create more competition.

[9] According to opensecrets.org the airline industry contributed almost 7 million dollars to political parties in 2000.The highest contributors were American Airlines with $1,415,847 followed closely by Northwest with $1,371,505.United, Delta and US Airways, the others in the top five had significantly lower contributions.

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and give those same adults the right of choosing the people who will make these very decisions is the worst kind of faulty logic.

Although all of the arguments focus on another issue, such as ensuring capacity or the importance of airlines to the economy, what the proponents of the bailout are really saying to the American people is, 'Trust me, you'll thank me for this someday. 'Too much trust in government does not usually yield what consumers want. It is much better to put trust in the market where at least it is known who is paying whom to do what.

II. A National Blunder

1. Government largesse

The U.S. government is giving the airline industry five billion dollars outright as well as ten billion in loans to prevent a failure in this sector of the economy. Many believe a rejuvenation of the air carriers is necessary for a recovery of America's faltering economy. However, the practice of subsidizing firms is unwarranted. If the government wishes to maximize the well-being of the economy with the correct policy, it would embrace the philosophy of laissez faire capitalism. A free economy is the only means – both necessary and sufficient – to assure both prosperity and economic justice.

Many problems overwhelmed the air companies well before the September 11 attacks. High operating expenses and a slowing economy were deteriorating the bottom line for nearly every airline. The Airline Handbook states that:

> Each major airline employs a virtual army of pilots, flight attendants, mechanics, baggage handlers, reservation agents, gate agents, security personnel, cooks, cleaners, managers, accountants, lawyers, etc. Computers have enabled airlines to automate many tasks, but there is no changing the fact that they are a service business, where customers require personal attention. More than one-third of the revenue generated each day by the airlines goes to pay its workforce. Labor costs per employee are among the highest of any industry. (*Airline Handbook*, online).

Fuel and excess capacity caused additional problems for the carriers. Gasoline is a substantial part of their total cost. When fuel prices began to rise in 2000, profits began to fall. Another challenge was excess capacity due to a miscalculation of demand for air travel. The Airline Handbook explains this problem:

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> Since aircraft purchases take time (often two to three years, if there is a production backlog), airlines also must do some economic forecasting before placing new aircraft orders. This is perhaps the most difficult part of the planning process, because no one knows for certain what economic conditions will be like many months or years into the future. An economic downturn coinciding with the delivery of a large number of expensive new aircraft can cause major financial losses. Conversely, an unanticipated boom in the travel market can mean lost market share for an airline that held back on aircraft purchases while competitors were moving ahead."(*Airline Handbook*, online).

With the unexpected drop in demand, many planes were built that have no current use. Airlines operate on thin profit margins. If a flight's costs are higher than its revenue, the parent company will not long allow it to continue. Otherwise, the company would be operating with a loss. Due to the decrease in demand, profit margins became thinner. As a result, many aircraft were idled. Further, demand for trips from smaller airports has substantially decreased. Therefore numerous flights that had previously been scheduled into the hub airports were no longer operating.

The government in its immense wisdom has decided this vital part of the economy cannot weaken. Its rationale: A stimulus plan, it maintains, is absolutely necessary for the prosperity of the economy. The bailout will keep thousands of airline workers employed, thus reducing the rate of unemployment. Since many firms will not be allowed to fail, numerous alternatives will be available for the passenger due to the increase in supply in the number of airlines available compared to a situation in which some would be allowed to fail. Ticket prices will also be kept down. This, in turn, will increase air travel,[10] thereby increasing the nation's overall commerce.

Such a skewed way of thinking is not grounded in reality and will only create additional problems. If the airlines are not allowed to downsize, a misallocation of resources occurs. Labor and capital are more greatly needed elsewhere, but the subsidy creates an incentive for labor and other inputs to continue work in the airline industry. Here is how Hazlitt analyzes saving a dying industry:

"It is obvious in the case of a subsidy that the taxpayers must lose precisely as much as the X industry gains. It should be equally clear that,

[10] Again, compared to the situation in which no subsidies to the airlines are forthcoming from government.

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as a consequence, other industries must lose what the X industry gains. They must pay part of the taxes that are supposed to support the X industry. And customers, because they are taxed to support the X industry, will have that much less income left with which to buy other things. The result must be that other industries on average must be smaller than otherwise in order that the X industry be large.

> But the result of this subsidy is not merely that there has been a transfer of wealth or income, or that other industries have shrunk in the aggregate as much as the X industry has expanded. The result is also that capital and labor are driven out of the industries in which they are more efficiently employed to be diverted to an industry in which they are less efficiently employed"(Hazlitt, 1946, pg. 101).

2. Economics of air transport

Airlines operate under the break-even load factor concept. This is based upon the percentage of seats an airline must sell at a given price level to cover its costs. As expenses increase, so does the break-even point. The bailout had no effect in terms of reducing costs. Therefore, the break-even point did not change. If a flight cannot cover its expenses, then it will not long continue to be scheduled. Because labor has a strong relationship to the number of flights conducted, many of these workers are being laid off in the aftermath of September 11. The airlines do not need the workers so they are let go. Carriers tend to retain those indirectly related to the flights. They constitute fixed costs. However, these firms are labor intensive. If demand is not present, there is no work to perform.

The five billion dollar subsidy hasn't affected the basic economic model. Demand hasn't increased. If anything, the very opposite has happened; and fuel and labor costs have remained high. If a company were considering whether or not to fly one of its planes, it would compare revenue with cost. If the latter outweighed the former, the flight would be grounded. If the company did decide to utilize the route, the airline would be incurring a loss.

Allen Sloan's article in Newsweek states that:

> Airlines are getting money for flights they canceled and to cover expenses such as salaries and fuel they will no longer incur (2001, pg. 65).

The basic principle of Hazlitt's argument still holds. The airlines may be cutting out unnecessary personnel, but they surely must still em-

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ploy labor that would not otherwise be kept on the books if the airlines had not been subsidized. This labor is, of course, misallocated.

The notion of the airlines being the lynchpin of the economy is vastly overdrawn. People see the carriers sustaining numerous businesses such as tourism. The commonly held notion is that if people quit flying planes, hotels, restaurants, car rentals, etc., will suffer grievously. This cannot be denied. But, if the economy were faltering, then tourism would be one of the first to go under in any case. Aircraft are just a means of transportation. If people reduce their demand for these services, it implies that either they are taking some other form of transportation or have less demand for travel or tourism. Why should the government subsidize something to ensure that supply does not fall if people have reduced their desire for it?

Ten billion dollars in government-backed loans have been granted to the airlines. Many see this as a necessity. Hazlitt (1946, p. 42) wrote:

> The common misconception over credit is that the cost to the government and to taxpayers is less than nothing because it is self-liquidating.

Why is something's being self-liquidating necessarily a bad thing? The answer lies in the nature of financial lending institutions. Private loans originate to convey resources from one party with excess monetary funds to another party with a greater need for them.

Financial institutions act in the same way. They bring together many lenders and borrowers. It is in their interest to direct the funds into the best investment for their customers. This may include the investment with the best rate of return for the amount of risk involved.[11] Financial institutions are going to lend money to parties with the greatest possible rate of return given the level of risk involved. If they had to choose between lending to the airlines and investing elsewhere, they would choose the project with the potential for the most profitable outcome. The airlines asked to borrow money, but the banks did not jump at the opportunity. Indeed, the very opposite was true. This implies a few things. One is that the rate of interest the airlines were offering was too low. Another is the risk involved was too great. A third possibility is that other projects seemed more profitable.

When the state bails out the airlines, funds are being transferred

[11] The institutions represent the wishes of their customers. Some institutions are willing to take extra risk for a greater return. This implies the customers with the funds are willing to take more risks as well.

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from their best use to less efficient ones, with a higher chance of failure. When government bureaucrats provide loans with money mulcted from taxpayers, they are taking risks with people's money they would not have undertaken on their own account. It is important to remember that what is really being commandeered is capital, not money. Money is only a medium of exchange. The government is actually diverting capital when it takes on the role of a financial institution. Recipients of government credit obtain their assets at the expense of those who would have been entrusted with private credit. At any point in time, only a limited amount of capital exists. When an organization obtains capital with government-backed loans, it denies organizations who would have received private loans the opportunity to purchase this capital. The result is a misallocation of capital from a low-risk organization to a high-risk one. The government seizes taxpayers' money and subsidizes bad loans[12].

Let's assume no private lending institution would have lent money to the airlines and that all investors would have considered them too high a risk. Loans would have been dispensed in other directions. Since the airlines would not have any additional resources with which to buy extra capital, manufacturers of inputs for the airlines would be forced to downsize. They would release their capital and labor to other industries where demand has increased. In contrast, subsidies misallocate resources.

J.D. Tucille wrote,

> Of all the arguments to be made against using taxpayer money to rescue the airlines from their financial doldrums, perhaps the best was offered by United Airlines itself. Just days after Congress approved a $15 billion bailout package for the industry, with an $802 million grant plus loan guarantees earmarked for United Airlines, its parent company made a down payment on 30 brand-new luxury business jets. (2001 online)

Despite this infusion, it is still not profitable to fly the planes. The taxpayers are bearing the costs of the new purchases.

---

[12] It cannot be denied that it is *possible* for the government to divert money from high to low risk ventures. After all the market is not perfect, and if the state engages in numerous subsidies, some few of them, conceivably, might be an improvement over what would have occurred under free enterprise. However, state subsidies do not benefit from the market's profit and loss survival test. When private entrepreneurs err, they suffer losses and thus are led by Adam Smith's invisible hand to change the error of their ways, or be brought up short by bankruptcy. No such automatic feedback mechanism operates in the public sector. Thus, we may readily expect far better results in the former case than in the latter.

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Landsburg also opposed the subsidies:

> So what does the airline bailout accomplish? One thing and one thing only – it enriches the millions of people who own airline stocks at the expense of the others who don't. And in the process, it undermines the very principles that we uphold and our enemies want to destroy. (2001 online)

III. Instead of a government subsidy

The government does not need to pursue any drastic stimulus plan to increase air travel. The market can do it on its own. What is needed is inaction on the part of the state, not action: i.e., laissez faire capitalism.

Consider the Federal Aviation Administration in this regard. The FAA has mandated lengthy check-ins for air travelers all over the country. It has replaced common sense with poorly conceived compulsory actions, not at all designed to stop terrorists from boarding passenger planes. Particularly vexing is its rule against racial profiling.[13] The brute fact is that all of the recent terrorist outrages in the airways have been perpetrated by males aged from 20-40 of Arab extraction. It is particularly galling to subject people not fitting this description to extensive searches.

States Paul Craig Roberts (2002) in this regard:

> You are not alone if you think it is odd we are killing Muslims in Afghanistan, but are afraid to profile Muslims in airport security.
>
> President Bush has won the war against the Taliban, but his transportation chief has taken the bloom off the victory by making air travelers feel like criminals in their own country. Transportation Secretary Norm Mineta, a Clinton-era holdover, has made a trip to the airport more painful than a trip to the dentist.
>
> All over the country, American citizens, who fit no terrorist profile, are being patted down in long airport security lines, their luggage rifled. Young mothers with children, elderly couples, even flight attendants and pilots are searched.
>
> It is mindless and pointless. If an airline pilot wants to hijack his airliner, he doesn't need a weapon. The detailed hand searches of his carry-on luggage are useless. Any bombs will be in the checked baggage,

[13] This actually a misnomer. More intensive scrutiny of those fitting the terrorist profile should be instead called "terrorist" profiling. Similarly, when police stop and search young black males in greater frequency than other age, sex, race categories, this is because of their disproportionate contribution to criminal statistics (Levin, 1997), not because of anything intrinsic to them as people. If this really were "racial" profiling, the police would subject to intensive inspection of black babies, black grandmothers, etc., which they most certainly do not.

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which is subject to no search whatsoever.

These lengthy security measures are only an added expense to the already struggling airlines. They have reduced demand due to the inconveniences associated with the waits and practices many consider an unnecessary invasion of privacy.[14] A three-hour boarding wait is a common occurrence at numerous airports. Policies such as these are wreaking havoc on the industry.

There is, of course, a need for heightened security measures in these dangerous times. But this does not at all mean they should be the responsibility of government. Rather, these should be transferred to the individual airlines, and the FAA completely abolished. Just as we expect better shoes, sofas and sailing ships from competitive markets, so does this apply to another consumer good, security. If some airlines do not provide the requisite security measures demanded by the customer, he will take his business elsewhere, to competitors who do satisfy his concerns. Many practical solutions, such as letting air personnel carry firearms, can be implemented. For example, the Israeli carrier EL Al requires an armed guard in plain clothes to attend each flight. Also, a reinforced steel door remains locked at all times.15 These are precisely the common sense policies that would be implemented by a private concern, faced with a loss of consumer revenue. The FAA, in sharp contrast, loses not a penny of its own money when it not only fails to introduce them, but actually prohibits them.

With our traditions of self-reliance and free markets seemingly under attack from terrorists, it ill behooves us to give them up at this crucial time in our nation's history. To do so would be to lose this "war." Our federal government has had a history of interfering with and regulating the free enterprise system. It needs now to reexamine its actions, which boomerang, in any case.[16]

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U.S. Government Grants and Special Interests: An Examination of the Immigration Industry –

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The U.S. government is attempting to promote welfare objectives by increased government grants to private non-profit organizations, but this policy has attracted considerable criticism. This article examines the disbursement of tax money in the form of government grants to one hundred and seventy non-profit organizations in the United States that benefit specific ethnic groups or lobby Congress in favor of increased immigration from selected countries. It classifies the recipients according to five categories; lists the amount each received; and quantifies their dependency on public funds. The paper analyzes the justifications for government grants and analyzes the arguments of those who claim that the union of politicians, special interests and tax money behind such government grants is undermining the principle of representative government.

Key Words: U.S. Government grants, special interests, non-profit organizations, immigration, lobbyists, tax-payers' rights, Catholic Charities USA, Hermanidad Mexicana Nacional, League of United Latin American Citizens, National Council of La Raza, One Stop Immigration Center.

As the distinction between the U.S. government and special interests becomes blurred, the present administration has sought to increase governmental grants to non-governmental religious and other organizations which engage in charitable activities. Government grants are an established means of achieving social objectives, and according to the "Consolidated Federal Funds Report (CFFR): Fiscal Year 2000," http://harvester.census.gov/cffr/asp/Geography.asp, in that fiscal year total government grants (Block, Formula, Project, and Cooperative Agreements) amounted to $308,529,508,893 – that is $308 billion dollars – however, some of this tax money is going to non-governmental religious and ethnic organizations, and as a result such grants are beginning to attract public attention.

The Catalogue of Federal Domestic Assistance (CFDA) lists the fifteen types of government assistance available, explaining that "[b]enefits and services of the programs are provided through seven financial types of assistance and eight non-financial types of assistance."

For detailed information the reader may refer to http://www.cfda.gov/public/browse_by_typast.asp, the website of the

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Catalogue of Federal Domestic Assistance. Click on the code letters A through 0 for a complete list of recipients (this appears in the third column "Program Title") and the name of the government agencies that provided the grant (this appears in the second column "Agency"). For specific data on each "Program Title," click on the "CFDA #" in the first column.

Each business day, "Notices of Funding Availability" (NOFAs) are printed in the Federal Register inviting applications for grants. While much of the $308 billion in grants for fiscal year 2000 went to projects which are non-discriminatory, such as medical assistance for elderly people, family support payments to States, and highway planning and construction, remarkably hundreds of millions of those dollars went to special interests that promote Third World immigration. These are often the same groups that lobby Congress and the President on U.S. immigration policy – e.g., amnesty for illegal aliens, admission of more "refugees," increased annual levels of legal immigration, etc. To obtain government grants, these special interest groups register with the Internal Revenue Service as non-profit organizations.

Examination of 171 Pro-Immigration Organizations
Receiving Government Grants

This paper discusses the logic, necessity, and legality of awarding government grants to such non-profit organizations. It does this by examining 171 non-profit organizations that promote Third World immigration into the United States. Their combined government grants totaled approximately $292 million. It is important to note this paper is limited to government grants and, therefore, does not include other types of government assistance to such non-profit organizations such as "direct public support," "indirect public support" and "government fees and contracts."

The amounts presented here for the government grants received by each of these 171 non-profit organizations were taken from their respective Internal Revenue Service Form 990 or 990EZ . [2]

It is important to note that while the operations of all 171 non-profit

[2] These figures were obtained from the Philanthropic Research Inc., 427 Scotland Street, Williamsburg, VA 23185, Tel. 800-784-9378. Its website, "GuideStar: The National Database of Non-Profit Organizations", at http://www.guidestar.org/, has complied such financial data "on more than 850,000 IRS recognized non-profit organizations". It is also important to note that these amounts are from the most recent IRS Forms 990 or 990EZ available at the time of the writing of this paper. The years cited for the grants, therefore, vary from 1997 to 2000. It is highly probable that more current data is now in the public domain.

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organizations are concerned with immigration, the extent of that involvement varies considerably. Some like the Catholic Legal Immigration Network, Coalition for Immigrant Refugee Rights & Services, Hebrew Immigrant Aid Society of Chicago, Immigration Advocacy Services, Latin American Immigrant & Refugee Organization, and One Stop Immigration Center deal primarily with immigrants and/or immigration-related issues. Others like Chicago Health Outreach, Farmworker Association of Florida, Jewish Community Council of Greater Coney Island, Legal Aid of Western Missouri, and Legal Services of New Jersey are involved in non-immigration issues as well.

Among grant recipients are powerful special interest groups that actively lobby Congress, the President, and the courts to have immigration policy advance their agendas. They include Catholic Charities USA, Hermanidad Mexicana Nacional, League of United Latin American Citizens, National Council of La Raza, National Immigration Forum, One Stop Immigration Center, and United Israel Appeal.

The three tables at the end of this paper disclose a number of interesting facts about these 171 non-profit organizations.

Some Observations Concerning these Grants

Purposes of Grant Recipients

1 – Ethnic/Racial or Religious.

Nearly two-thirds (64.3 percent) can be classified as either "ethnic/racial" (71) or "religious" (39) in orientation. See Table A.

2 – Several Exist Solely as a result of Government Grants.

Many of the "ethnic/racial" non-profit organizations are, in fact, the financial creations of the U.S. government; that is, without government grants, they could not function. For example, the percentage of government grants to the total revenues of several of these non-profit organizations was:

- African Community Refugee Center – 93.7%.
- Cambodian Mutual Assistance Association – 96.7%.
- Ethiopian Community Association of Missouri – 70.2%.
- Greater Philadelphia Overseas Chinese Association – 89.9%.
- Haitian Community Refugee Center – 100%.
- Kurdish Human Rights Watch – 81.0%.
- La Cooperative Campesina de California – 99.9%.

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- La Crosse Area Hmong Mutual Assistance Association – 90.8%.
- Latin American Immigrant & Refugee Organization – 97.1%.
- National League of Cuban American Community Based Centers – 99.8%.

See Table B for the corresponding percentages of all 171 non-profit organizations.

By this practice, the U.S. government is emulating the Ford Foundation, which provided "seed" grants to create and subsequent grants to maintain the Mexican American Legal Defense and Educational Fund (MALDEF) and the National Council of La Raza. The significant difference is that the Ford Foundation uses its own money, not that of U.S. taxpayers.

3 – Promotion of Immigrant Resettlement.

Some grants are being given to promote the resettlement of Third World immigrants in areas of the country that are not the traditional destination for 20th Century immigrants. Such areas include Georgia, Indiana, Kansas, Kentucky, Louisiana, Minnesota, Missouri, Nebraska, North Carolina, Ohio, Tennessee, Wisconsin, and the Mohawk Valley of New York State.

4 – Catholic Charities as Grant Recipients.

Catholic Charities USA is an umbrella organization of approximately 1,400 local agencies. While it was the recipient of a generous grant of $800,292, separate grants were also made to a number of these local agencies in amounts greater than the one to Catholic Charities USA, itself. For example:

- Associated Catholic Charities – $1,082,167.
- Associated Catholic Charities of Galveston-Houston (TX) – $2,279,026.
- Catholic Charities of New Orleans (LA) – $14,046,180.
- Catholic Charities of Orange County (CA) – $1,959,596.
- Catholic Charities of San Diego (CA) – $8,326,861.
- Catholic Charities of San Jose (CA) – $4,711,064.
- Catholic Charities of Southern Nevada – $4,998,756.
- Catholic Charities, Inc. $4,915,876.
- Catholic Family & Community Services, Inc. $5,389,351.

See Table C for the amount of the government grant received by

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each of the 171 non-profit organizations.

5 – $70 million to United Israel Appeal.

United Israel Appeal received $70,000,000, which was the largest grant given to single non-profit organization dealing with immigration. Interestingly, this grant went to assist the resettlement of refugees in Israel, not the United States. This amount, however, was not vital to the stated objective of this organization since it represented just 21.3% of its total revenue.

6 – Recipients That Are Not Dependent on Grants.

Grants to some organizations are so small, either monetarily or as a percentage of their total revenues, they are not necessary to their operations. For example:

- $1,470 to the Japanese American Social Service, Inc. represented only 0.7 percent of its total revenue.
- $75,000 to the International Institute of Boston, Inc. represented only 1.6 percent of its total revenue.
- $710,219 to Lutheran Social Services of South Dakota represented only 8.1 percent of its total revenue.
- $966,201 to Jewish Family and Children's Services (CA) represented only 4.5 percent of its total revenue.
- $1,082,167 to Associated Catholic Charities represented only 4.3 percent of its total revenue.

Questions of Constitutionality and Legality

7 – Questions of Constutionality.

While this list of 171 non-profit organizations is not meant to be exhaustive, it is extensive and provides an accurate overview of the government grants that have led critics in the U.S.A. to denounce such governmental activities on the grounds that the U.S. Constitution does not confer on Congress any power to dispense tax money to private agencies.

While the preamble to the U.S. Constitution declares that one of the purposes for establishing the federal government was to "promote the general Welfare," Article 1, Section 8 of that document lists the specific powers delegated to Congress. Dispensing tax money to private organizations is not among these.

Critics also complain that many of the grants are made to organiza-

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tions established to benefit specific religious groups and that this violates the First Amendment to the American Constitution as to Religion. Dispensing tax money to officially selected religious organizations is a violation of the First Amendment and, therefore, unconstitutional.

This objection is based on the argument that when Congress enacts laws providing tax money to various officially selected religious organizations – often Catholic, Protestant and Jewish – Congress is in effect violating the First Amendment's injunction to "make no law respecting an establishment of religion." To select particular religiously-base organizations as beneficiaries of tax money while denying tax money to other religious organizations, e.g., Reverend Farrakhan's Nation of Islam, Reverend Moon's Unification Church, Hari Krishnas, critics argue that Congress may be in effect be violating the First Amendment's injunction against "prohibiting the free exercise" of those religions. This argument is tenuous, but more credibly, by officially treating religious organizations unequally (by assisting some with government grants and penalizing others by denying them such grants), Congress is accused of engaging in religious discrimination, which is more clearly against U.S. constitutional law.[3]

Attempting to defend these government grants by pleading that the tax money is being given not to finance religious activities but to fund general social service programs that just happen to be provided by religious organizations is likewise seen as specious for two reasons. First, as already noted, government agencies already exist to provide such social services and this dispersal of tax money simply deprives them of the needed funds to properly perform that function. Second, even if these religious organizations were to use the government grants only to provide social services to the general community, that tax money would still be an indirect subsidy in that it enables such officially favored religions to operate their social service programs at a savings while applying those savings to sectarian purposes – i.e., funding missionary work, financing church/synagogue activities and schools, hiring religious school teachers and, not least, lobbying Congress and State legislatures in support of or opposition to abortion, capital punishment, contraception, disarmament, divorce, euthanasia, marriage, school vouchers, Third World debt relief, etc.

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[3] Reference is made by critics to the U.S. Supreme Court decision in "Church of Lukumi Babalu Aye, Inc. v. City of Hialeah", 508 U.S. 520 (1993) which declared unconstitutional the enactment by government of any laws, rules, or regulations that discriminate against a specific religion because politicians disapprove of its religious beliefs and/or practices.

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Without government grants these religions could not afford to operate both their social service programs and sectarian activities at their current financial levels. Therefore, U.S. taxpayers, without their consent and often without their knowledge, are being made to indirectly fund religions which they may not wish to support. This would seem to violate the taxpayers' constitutional rights under the "due process" clause of the Fifth Amendment and the "equal protection" clause of the Fourteenth Amendment.

8 – That the Grants Violate Civil Rights Laws as to Prohibited Discrimination.

It is further objected that dispensing tax money to officially approved racial/ethnic organizations is illegal under U.S. Civil Rights laws.

Where the recipients are organized on a national or ethnic basis, the making these grants Congress is seen as violating US Code: Title 42, Chapter 21 – Civil Rights, which prohibits discrimination based on race, color, religion, sex, or national origin. Since a government grant made to an officially selected organization that is organized for the benefit of a specific racial, ethnic or national group, is, in effect, a "federally assisted program," Congress is accused of specifically violating Subchapter V (Federally Assisted Programs, Section 2000d, Chapter 21, Title 42) which states that "No person in the United States shall, on ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance."[4]

Fundamental to these complaints is the argument that not all religious, ethnic, or racial non-profit organizations receive government grants, only those which Congress or state legislatures have selected to receive grants. Critics maintain that since approval is determined by political considerations, principally by the legislators' need to attract campaign contributions, win voting blocs, the way this tax money is dispensed is inherently discriminatory.

Those ethnic/racial non-profit organizations that represent communities that are politically unorganized or underorganized, do not maintain effective lobbyists in Washington, DC or in the state capitals, or are not members of an officially-recognized "historically oppressed minority," will likely not receive government grants.

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[4] While this section of Subchapter V is remarkable for omitting a prohibition against religious discrimination, it is held that even grants to organizations that have only a religious basis are still subject to section 2000d since it is repeatedly cited throughout Chapter 21.

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In fact it is true that, judging by the 171 non-profit organizations examined in this study, the race, color, and national origin of an ethnic/racial non-profit organization appear to be very important factors for legislators when deciding which will receive a government grant and which will not. For example, it is more probable that a Hispanic non-profit organization, like the National Council of La Raza, will receive a government grant than a Slavic non-profit organization, such as the Polish American Congress.

Therefore it is argued that both the method by which government grants are dispensed, and the disparate impact of those grants on ethnic/racial non-profit organizations violate US Code: Title 42, Chapter 21 – Civil Rights, prohibiting discrimination based on race, color, religion, sex, or national origin.

If the 171 non-profit organizations examined in this paper accurately reflect the religious/ethnic breakdown of all recipients of government grants, which would appear to be the case, then it would seem undeniable that discrimination is endemic to the current U.S. policy of dispensing government grants to private organizations.

Separate from illegal racial discrimination in dispensing government grants is the question of racial discrimination in how that tax money is used. The purpose of government grants to officially approved ethnic/racial non-profit organizations is to help fund social services meant to benefit primarily, if not exclusively, only members of those communities. Such use of tax money also violates U.S. Code: Title 42, Chapter 21 – Civil Rights, which outlawed discrimination based on race, color, religion, sex, or national origin.

As with respect to religious non-profit organizations, it is similarly argued that government grants to ethnic/racial non-profit organizations reduce the level and quality of the social services made available by federal and State agencies to people who are not of those ethnic/racial groups. Such a practice violates the "due process" clause of the Fifth Amendment and "equal protection" clause of the Fourteenth Amendment.

9 – *That Unconstitutionally Compel Contributions from Private Individuals.*

And one further legal objection is raised by critics of government grants to non-profit organizations. In Lehnert v. Ferris Faculty Association, 500 U.S. 507 (1991), the Supreme Court of the United States ruled that the use of union dues by a union to fund non-union activities was

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unconstitutional. The Court declared "...we hold that the State constitutionally may not compel its employees to subsidize legislative lobbying or other political union activities outside the limited context of contract ratification or implementation." They claim that the constitutional principle behind that ruling likewise prohibits the government from using tax money "compelling" U.S. citizens and legal residents to "subsidize" nonprofit organizations that engage in lobbying.

Other Points of Criticism

10 – That Create Duplication.

The grants waste tax money by duplicating services.

11 – That Cause a Drain of Resources.

The grants deprive government agencies of the funding necessary to operate effectively and efficiently.

It is also argued that any attempt to justify the practice of making government grants to private organizations under the heading of "promoting the general Welfare" is illogical and counterproductive. For example, it is pointed out, if immigration levels are so great that those agencies, bureaus, and departments of the federal and state governments that provide social services to immigrants cannot adequately perform their job, then giving tax money to private organizations to provide these same services is illogical. The problem lies with the sheer number of immigrants, legal and illegal, being admitted – well over one million annually. The logical response would be for Congress to enact a moratorium on all immigration until federal and State agencies can fulfill their responsibilities to the immigrants already here. Once that has been accomplished, logic would then dictate that Congress prevent those public agencies from ever again being overwhelmed in the future by restoring annual immigration numbers to more traditional levels of around 250,000.

On the other hand, it can be claimed, if the annual level of immigration is not a problem and government agencies are not being overwhelmed by the numbers of immigrants, then giving tax money to private organizations to provide similar social services is counter productive.

12 – That Increase the Potential for Fraud.

It increases the potential for fraud by diverting tax money to a multitude of private organizations.

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13 – That Promote Discrimination.

It facilitates discrimination by enabling private organizations to provide services that disproportionately favor their own ethnic/racial/religious communities.

Conclusion

In summary, critics of government grants to non-profit organizations that benefit only specific communities claim that taxes are paid to support the federal and state governments, not to support private organizations, and that diverting any portion of such public funds to specific non-profit organizations that benefit only selected ethnic or racial communities corrupts the entire political process, and in effect transforms the United States from a representative republic into a government of special interests.

This subject has been treated at greater length by the author in a paper entitled "The Improper Use of Public Grants: Special Interest, and Immigration, by the same author, published by the American Immigration Control Foundation, Box 525, Monterey, Virginia 24465

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TABLE A

The 171 Non-Profit Organizations Classified According to Five Categories

Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
(The) Brooklyn Historical Society, Brooklyn, NY Grant – $523,431 FY – 4/30/1998	African Community Refugee Center, Inc. Los Angeles, CA Grant – $363,768 FY – 6/30/1998	Acre Family Day Care Corp. Lowell, MA Grant – $1,852,031 FY – 12/31/1999	Camba Legal Services Brooklyn, NY Grant – $392,967 FY – 6/30/2000	Associated Catholic Charities Washington, DC Grant – $1,082,167 FY – 6/30/2000
Center – for Educational Telecommunications Berkeley, CA Grant – $33,000 FY – 12/31/1997	African Services Committee, Inc. New York, NY Grant – $477,508 FY – 5/31/ 1998	American Civic Association Binghamton, NY Grant – $65,854 FY – 12/31/1999	Community Legal Services and Counseling Center, Inc Cambridge, MA Grant – $35,000 FY – 6/30/1999	Associated Catholic Charities of Diocese of Galveston-Houston, TX Grant – $2,279,026 FY – 12/31/1998
Lower East Side Tenement Museum New York, NY Grant – $145,102 FY – 6/30/1999	Alse Clemente Center, Inc. East Chicago, IL Grant – $130,727 FY – 12/31/1998	Austin-Travis County Refugee Services Austin, TX Grant – $73,405 FY – 9/30/1999	Farmworker Justice Fund, Inc. Washington, DC Grant – $86,012 FY – 9/30/1998	Caritas of Austin Austin, TX Grant – $1,445,550 FY – – 9/30/1999
Making A Difference Foundation Virginia Beach, VA Grant – $89,252 FY – 12/31/1999	Asian Americans for Equality, Inc. New York, NY Grant – $573,993 FY – 12/31/1998	Bridge Refugee and Sponsorship Services, Inc. Knoxville, TX Grant – – $436,380 FY – 12/31/1999	GLCSAC Voluntary Legal Services Corp. Los Angeles, Ca Grant – $651,779 FY – 6/30/1998	Catholic Charities, Inc. Wilmington, DE Grant – $4,915,876 FY – 6/30/1999
Tacoma Community House Tacoma, WA Grant – $2,052,243 FY – 12/31/1999	Asian Law Caucus, Inc. San Francisco, CA Grant – $189,838 FY – 6/30/2000	Center for Cultural Dynamics Englewood, CO Grant – – $142,740 FY – – 6/30/1999	Greater Boston Legal Services, Inc Boston, MA Grant – $5,075,509 FY – 12/31/1999	Catholic Charities Archdioceses of – New Orleans, LA Grant – $14,046,180 FY – 6/30/1999
	Asian Women United St. Paul, MN Grant – $131,297 FY – 6/30/1999	Center for New Americans Northampton, MA Grant – $401,392 FY – 8/31/2000	Immigration Advocacy Services, Inc Astoria, NY Grant – $36,515 FY – 12/31/1998	Catholic Charities Diocese of Beaumont, TX Grant – $58,483 FY – 6/30/1999
	Asociacion Pro Sevicios Sociales, Inc. Laredo, TX Grant – $195,890 FY – 12/31/1998	Center for New Americans Walnut Creek, CA Grant – $19,913 FY – 12/31/1999	Justice Information Center, Inc. Denver, CO Grant – $36,182 FY – 12/31/1998	Catholic Charities of Diocese of Rockford, IL Grant – $704,275 FY – 6/30/2000
	Ayuda Washington, DC Grant – 66,603 FY – 6/30/1999	Chicago Health Outreach Inc. Chicago, IL Grant – $8,619,326 FY – 6/30/2000	Legal Aid Foundation – of Los Angeles, CA Grant – $5,995,348 FY – 6/30/1999	Catholic Charities of Diocese of San Diego, CA Grant – $8,326,861 FY – 6/30/1999

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Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
	Boat People SOS, Inc. Fairfax, VA Grant – $41,250 FY – 12/31/1999	Coalition of Immigrant Refugee Rights & Services San Francisco, CA Grant – $268,806 FY – 12/31/1997	Legal Aid of Western Missouri Kansas City, MO Grant – $3,356,900 FY – 12/31/1999	Catholic Charities Diocese of Venice, FL Inc. Grant – $347,528 FY – 6/30/1999
	Brooklyn Chinese American Association Grant – $429,132 FY – 6/30/1998	Community Action Board of Santa Cruz County, CA Grant – $1,285,360 FY – 12/31/1998	Legal Services of New Jersey, Inc Edison, NJ Grant – $19,041,990 FY – 12/31/1999	Catholic Charities of Orange County, CA Grant – $1,959,596 FY – 6/30/1999
	Cambodian Association of Greater Philadelphia Philadelphia, PA Grant – $124,780 FY – 3/31/1999	East Central Illinois Refugee Mutual Assistance Center Urbana, IL Grant – $70,002 FY – 6/30/1999	Los Angeles Center of Law and Justice Los Angeles, CA Grant – $349,691 FY – 6/30/1999	Catholic Charities of San Jose, CA Grant – $4,711,064 FY – 6/30/1998
	Cambodian Mutual Assistance Association Columbus, OH Grant – $169,677 FY – 6/30/1998	Farmworker Association of Florida Apopka, Fl Grant – $136,502 FY – 8/31/1998	Northwest Immigrants Rights Project Seattle, WA Grant – $309,691 FY – 12/31/1999	Catholic Charities of Southern Nevada Grant – $4,998,756 FY – 6/30/1999
	(The) Cambodian Mutual Assistance Association of Greater Lowell, Inc. Lowell, MA Grant – $195,865 FY – 6/30/2000	Gage County Economic Development, Inc. Beatrice, NE Grant – $172,859 FY – 9/30/1999	One Stop Immigration Center Los Angeles, CA Grant – $660,491 FY – 6/30/1997	Catholic Charities USA Alexandria, VA Grant – $800,292 FY – 12/31/1998
	Central American Legal Assistance Brooklyn, NY Grant – $15,000 FY – 12/31/1998	Genesis Center Providence, RI Grant – $236,801 FY – 8/31/1998	Political Asylum Project of Austin Austin, TX Grant – $38,352 FY – 12/31/1999	Catholic Family & Community Services, Inc. Paterson, NJ Grant – $5,389,351 FY – 6/30/1998
	Central American Resource Center – of California Los Angeles, CA Grant – $40,504 FY – 12/31/1997	Immigration Project Staunton, IL Grant – $44,414 FY – 6/30/1999	San Francisco Bar Association Volunteer Legal Services, CA Grant – $801,232 FY – 12/31/1998	Catholic Legal Immigration Network Grant – $565,948 FY – 12/31/1998
	Centre for Asians and Pacific Islanders Minneapolis, MN Grant – $376,118 FY – 12/31/1998	Intercultural Mutual Assistance Association of SE Minnesota Rochester, MN Grant – $641,530 FY – 6/30/2000		Catholic Social Center Service of Central and Northern Arizona Grant – $13,425,733 FY – 6/30/2000

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Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
	Centro Legal, Inc. St. Paul, MN Grant – $128,104 FY – 12/31/1999	International Center of Capital Region, Inc Albany, NY Grant – $152,447 FY – 12/31/1998		Catholic Social Services, Inc. Atlanta, GA Grant – $1,525,238 FY – 6/30/2000
	Centro Romano Chicago, IL Grant – $277,163 FY – 12/31/1998	International Institute of Boston Boston, MA Grant – $75,000 FY – 6/30/1999		Catholic Social Services of Albuquerque, NM Grant – $1,919,459 FY – 6/30/1999
	Chinatown Service Center Los Angles, CA Grant – $2,255,799 FY – 6/30/1999	International Institute of Buffalo Buffalo, NY Grant – 429,591 FY – 10/31/1998		Catholic Social Services of Santa Fe, NM Grant – $31,411 FY – 6/30/19999
	Chinese Newcomers Service Center San Francisco, CA Grant – $30,927 FY – 6/30/1998	International Institute of Connecticut Bridgeport, CT Grant – $503,438 FY – 12/31/1998		Church Alive Bronx, NY Grant – $5,000 FY – 12/31/1998
	Colombian American Service Association, Inc. (CASA) Grant – $3,858 FY – 12/31/1999	International Institute of Greater Toledo, Ohio Grant – $2,932 FY – 12/31/1998		Episcopal Social Services of the Diocese of Connecticut, Inc. New haven, CT Grant – – $360,080 FY – 12/31/1999
	Concerned Citizens of Queens, NY – Ciudadanos Conscientes of Queen I Grant – $108,184 FY – 12/31/1998	International Institute of Los Angeles, CA Grant – $9,730,023 FY – 6/30/1998		Hebrew Immigrant Aid Society of Chicago Chicago, IL Grant – $287,680 FY – 6/30/1999
	Council of Latino Agencies Washington, DC Grant – $198,425 FY – 9/30/1998	International Institute of New Jersey Jersey City, NJ Grant – $816,569 FY – 9/30/2000		Immigrant Center (Episcopal Church) Honolulu, HI Grant – $2,683,170 FY – 6/30/2000
	Cuban American National Council, Inc. Miami, Fl Grant – $3,002,862 FY – 12/31/1998	International Institute of Rhode Island Providence, RI Grant – $397,732 FY – 6/30/1999		Interchurch Refugee and Immigration Ministries, Chicago, IL Grant – $2,089,986 FY – 6/30/2000
	Dominican Women's Development Center New York, NY Grant – $244,572 FY – 9/30/1998	International Institute of San Francisco, CA Grant – $416,725 FY – 6/30/1999		Interfaith Ministries for Greater Houston, TX Grant – $2,250,721 FY – 12/31/1998

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Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
	Eau Claire Area Hmong Mutual Assistance Association, Inc. Eau Claire, WI Grant – $300,012 FY – 9/30/1999	International Institute of the East Bay Oakland, CA Grant – $446,472 FY – 6/30/1998		Jackson Heights-Elmhurst Kehillah, New York, NY Grant – $89,983 FY – 6/30/199
	El Rescate Los Angeles, CA Grant – $233,534 FY – 12/31/1997	Ireo Portland, OR Grant – $3,428,469 FY – 9/30/1999		Jewish Community Council of Greater Coney Island, Inc. Brooklyn, NY Grant – $3,119,627 FY – 6/30/1999
	Ethiopian Community Association of Missouri St. Louis, MO Grant – $59,728 FY – 6/30/1999	Mohawk Valley Resource Center for Refugees Utica, NY Grant – $1,152,937 FY – 2/28/2000		Jewish Council of Yonkers, Inc. Yonkers, NY Grant – $74,064 FY – 6/30/1999
	Ethiopian Community Center, Inc. Washington, DC Grant – $74,969 FY – 12/31/1998	National Immigration Forum, Inc. Washington, DC Grant – $285,976 FY – 12/31/1999		Jewish Family and Children's Services Minneapolis, MN Grant – $51,398 FY – 8/31/1998
	Ethiopian Community Development Council Arlington, VA Grant – $1,991,230 FY – 9/30/1999	Nationalities Service Center of Philadelphia, PA Grant – $521,988 FY – 5/31/1998		Jewish Family and Children's Services San Francisco, CA Grant – $966,201 FY – 6/30/1999
	Foreign-Born Information and Referral Network, Inc. Columbia, MD Grant – $140,354 FY – 6/30/1999	New York Immigration Coalition, Inc. New York, NY Grant – $5,863 FY – 7/31/1999		Jewish Family and Children's Services of the East Bay, Berkeley, CA Grant – $473,188 FY – 6/30/2000
	Fresno Center for New Americans (SE. Asians) Fresno, CA Grant – $536,079 FY – 12/31/1999	North Hudson Community Action Corp. West New York, NJ Grant – $6,917,942 FY – 1/31/1999		Jewish Family Service of Rockland County New City, NY Grant – $27,500 FY – 6/30/1999
	Greater Philadelphia Overseas Chinese Association Philadelphia, PA Grant – $83,883 FY – 12/31/1998	Northern Manhattan Coalition for Immigrants Rights New York, NY Grant – $128,377 FY – 12/31/1998		Lutheran Social Services of South Dakota Sioux Falls, SD Grant – $710,219 FY – 6/30/1999

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Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
	Haitian Community Refugee Center, Inc. Los Angeles, CA Grant – $170,707 FY – 3/31/2000	Private Industry Council of the City of New York New York, NY Grant – $4,052,320 FY – 6/30/1999		Saint Anselms Cross Cultural Community Center Garden Grove, CA Grant – $880,697 FY – 9/30/1998
	Hermandad Mexicana Nacional Los Angeles, CA Grant – $431,037 FY – 6/30/1999	Refugee & Immigrant Forum of Snohomish County Everett, WA Grant – $646,032 FY – 9/30/1999		Tucson Ecumenical Council Legal Assistance Tucson, AZ Grant – $9,206 FY – 12/31/1997
	Hispanic Committee of Virginia Falls Church, VA Grant – $535,283 FY – 6/30/1999	Refugee Services Alliance Houston, TX Grant – $1,693,052 FY – 9/30/19999		UJA Federation Westport-Weston-Wilton-Norwalk CT Grant – $3,510 FY – 8/31/1998
	Hmong American Friendship Association Milwaukee, WI Grant – $595,462 FY – 12/31/1999	South Jamaica Services for Families & Children Richmond Hill, NY Grant – $2,113,350 FY – 12/31/1998		United Israel Appeal New York, NY Grant – $70,000,000 FY – 12/31/1998
	Hmong American Partnership St. Paul, MN Grant – $2,587,875 FY – 12/31/1999	The Coalition of Florida Farmworker Organizations, Inc Homestead, FL Grant – $818,164 FY – 9/30/1999		U.S. Catholic Conference Associated Catholic Charities Oklahoma City, OK Grant – $134,637 FY – 6/30/1998
	Indochinese Community Center Washington, DC Grant – $1,030,999 FY – 6/30/1999	Travelers & Immigrants Aid – Chicago Connection Chicago, IL Grant – $13,795,743 FY – 6/30/2000		U.S. Catholic Conference Diocesan Migrant and Refugee El Paso, TX Grant – $52,482 FY – 6/30/1999
	Japanese American Social Services, Inc. New York, NY Grant – $1,470 FY – 6/30/1999	Vive, Inc. Buffalo, NY Grant – $362,265 FY – 6/30/1999		
	Korean Community Center of the East Bay Oakland, CA Grant – $26,100 FY – 12/31/1998	Western Kentucky Refugee Mutual Assistance Society Bowling Green, KY Grant – $715,715 FY – 6/30/1999		

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Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
	Kurdish Human Rights Watch, Inc. Fairfax, VA Grant – $845,520 FY – 12/31/1999			
	La Comunidad Hispana Kennett, PA Grant – $275,050 FY – 6/30/1999			
	La Cooperativa Campesina de California Sacramento, CA Grant – $20,731,666 FY – 12/31/1998			
	La Crosse Area Hmong Mutual Assistance Association, Inc La Crosse, WI Grant – $640,142 FY – 9/30/2000			
	La Raza Centro Legal – San Francisco, CA Grant – $367,299 FY – 6/30/1999			
	Latin American Association Atlanta, GA Grant – $64,765 FY – 6/30/1999			
	Latin American Immigrant & Refugee Organization, Inc. West Palm Beach, FL Grant – $184,114 FY – 12/31/1999			
	League of United Latin American Citizens Washington, DC Grant – $2,962,372 FY – 9/30/1999			

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Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
	Libreria Del Pueblo San Bernardino, CA Grant – $743,824 FY – 6/30/1999			
	Maryland Vietnamese Mutual Association Wheaton, MD Grant – $7,250 FY – 12/31/1999			
	(The) Montagnard Dega Association, Inc. Greensboro, NC Grant – $89,739 FY – 6/30/1998			
	Nassau County Hispanic Foundation Garden City, NY Grant – $21,280 FY – 6/30/1998			
	National Council – of La Raza Washington, DC Grant – $3,085,192 FY – 9/30/1998			
	National League of Cuban American Community Based Centers, Inc. Fort Wayne, IN Grant – $626,409 FY – 6/30/1999			
	Nosotros Tucson, AZ Grant – $248,928 FY – 6/30/1999			
	Sacramento Chinese Community Service Center Sacramento, CA Grant – $597,272 FY – 6/30/1999			
	Social & Cultural RDI, Inc. Houston, TX Grant – $320,994 FY – 12/31/1999			

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Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
	South Asian Network Artesia, CA Grant – $95,329 FY – 12/31/2000			
	Southeast Asian Mutual Assistance Association Garden City, KS Grant – $129,333 FY – 12/31/1999			
	Southeast Asian Refugee Community House – Search Minneapolis, MN Grant – $104,830 FY – 12/31/1999			
	Spanish Catholic Center, Inc. Washington, DC Grant – $161,551 FY – 6/30/1999			
	Spanish Center – Joliet, IL Grant – $130,472 FY – 12/31/1998			
	Spanish Speaking Citizens Foundation Oakland, CA Grant – $447,729 FY – 6/30/1999			
	United Cambodian Association of Minnesota St. Paul, MN Grant – $605,330 FY – 12/31/1999			
	Vietnamese Association of Illinois Chicago, IL Grant – $806,438 FY – 6/30/2000			
	Vietnamese Friendship Association Seattle, WA Grant – $34,162 FY – 12/31/1999			

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Educational	*Ethnic/Racial*	*General*	*Legal*	*Religious*
	Vietnamese Social Services of Minnesota St. Paul, MN Grant – $692,636 FY – 12/31/1999			
	Westchester Hispanic Coalition, Inc. White Plains, NY Grant – $426,539 FY – 6/30/1999			
	Wichita Indochinese Center Wichita, KS Grant – $458,613 FY – 12/31/1997			
	Women's Association of Hmong and Lao, Inc. St. Paul, MN Grant – $434,119 FY – 12/31/1999			

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TABLE B

Government Grant as Percentage of Total Revenue of the 171 Non-Profit Organizations

<=10 percent	*>10 percent – 25 percent*	*>25 percent – 50 percent*	*>50 percent – 75 percent*	*>75 percent – 90 percent*	*>90 percent – 100 percent*
Associated Catholic Charities Grant – $1,082,167 Revenue – $25,217,766 4.3%	Asian Law Caucus, Inc. Grant – $189,836 Revenue – $1,229,679 15.4%	Alse Clemente Center, Inc Grant – $130,727 Revenue – $276,558 47.3%	Catholic Charities, Inc. Grant – $4,915,876 Revenue – $8,490,644 57.9%	Acre Family Day Care Corp. Grant – $1,852,031 Revenue – $2,195,133 84.4%	African Community Refugee Center Grant – $363,768 Revenue – $388,268 93.7%
Ayuda Grant – $66,603 Revenue – $698,650 9.5%	Boat People SOS, Inc. Grant – $41,250 Revenue – $223,246 18.5%	American Civic Association, Inc. Grant – $65,854 Revenue – $160,904 40.9%	Catholic Charities Archdiocese of New Orleans Grant – $14,046,180 Revenue – $20,130,088 69.8%	Bridge Refugee and Sponsorship Services Grant – $436,380 Revenue – $489,203 89.2%	African Services Committee, Inc Grant – $477,508 Revenue – $478,737 99.9%
Cambodian Mutual Assistance Association of Greater Lowell Grant – $195,865 Revenue – $2,996,617 6.5%	Catholic Charities Diocese of Venice, Ins. Grant – $347,528 Revenue – $2,536,839 13.7%	Asian American for Equality, Inc. Grant – $573,993 Revenue – $1,726,076 33.3%	Catholic Charities of Diocese of San Diego Grant – $8,326,861 Revenue – $11,159,200 74.6%	Catholic Family & Community Services, Inc. Grant – $5,389,351 Revenue – $7,032,072 76.6%	Camba Legal Services, Inc. Grant – $392,967 Revenue – $392,967 100%
Catholic Charities Diocese of Beaumont Grant – $58,483 Revenue – $5,901,900 1.0%	Catholic Charities USA Grant – $800,292 Revenue – $7,547,309 10.6%	Asian Women United Grant – $131,297 Revenue – $295,027 44.5%	Catholic Charities of Southern Nevada Grant – $4,998,756 Revenue – $9,655,406 51.8%	Center For New Americans (MA) Grant – $401,392 Revenue – $458,789 87.5%	Cambodian Mutual Assistance Association Grant – $169,677 Revenue – $174,935 96.7%
Catholic Charities of the Diocese of Rockford Grant – $704,275 Revenue – $7,141,615 9.8%	Catholic Legal Immigration Network, Inc. Grant – $565,948 Revenue – $4,319,017 13.1%	Asociacion Pro Servicios Sociales, Inc. Grant – $195,890 Revenue – $405,271 48.3%	Catholic Social Services of Albuquerque, Inc. Grant – $1,919,459 Revenue – $2,767,678 69.4%	Chicago Health Outreach, Inc Grant – $8,619,326 Revenue – $9,759,191 88.3%	Center for Cultural Dynamics Grant – $142,740 Revenue – $142,740 100%

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<=10 percent	*>10 percent – 25 percent*	*>25 percent – 50 percent*	*>50 percent – 75 percent*	*>75 percent – 90 percent*	*>90 percent – 100 percent*
Central American Legal Assistance Grant – $15,000 Revenue – $243,553 6.2%	Catholic Social Services of Santa Fe, Inc. Grant – $31,411 Revenue – $215,555 14.6%	Associated Catholic Charities of the Diocese of Galveston-Houston Grant – $2,279,026 Revenue – $6,152,533 37.0%	Catholic Social Service of Central and Northern Arizona Grant – $13,425,733 Revenue – $18,251,363 73.6%	Eau Claire Area Hmong Mutual Assistance Association, Inc. Grant – $300,012 Revenue – $386,410 77.6%	Haitian Community Refugee Center, Inc. Grant – $170,707 Revenue – $170,707 100%
Church Alive Development Corp. Grant – $5,000 Revenue – $98,349 5.1%	Center for telecommunications Inc. Grant – $33,000 Revenue – $310,347 10.6%	Austin-Travis County Refugee Services Grant – $73,405 Revenue – $240,007 30.6%	Centre for Asians and Pacific Islanders Grant – $376,118 Revenue – $681,489 55.2%	Episcopal Social Service of the Diocese of Connecticut Grant – $360,080 Revenue – $418,763 86.0%	Immigrant Center Grant – $2,683,170 Revenue – $2,970,579 90.3%
Colombian American Service Association, Inc. Grant – $3,858 Revenue – $39,384 9.8%	Central American Resource Center – Carecen – of California Grant – $40,504 Revenue – $253,629 16.0%	Brooklyn Chinese-American Association, Inc. Grant – $429,132 Revenue – $868,668 49.4%	Centro Romero Grant – $277,163 Revenue – $482,549 57.4%	Farmworker Justice Fund, Inc Grant – $86,012 Revenue – $106,563 80.7%	International Institute of Los Angeles Grant – $9,730,023 Revenue – $10,599,682 91.8%
Community Legal Services and Counseling Center, Inc. Grant – $35,000 Revenue – $494,613 7.1%	Centro Legal, Inc Grant – $128,104 Revenue – $889,778 14.4%	(The) Brooklyn Historical Society Grant – $523,431 Revenue – $1,590,505 32.9%	Chinatown Service Center Grant – $2,255,799 Revenue – $3,252,610 69.4%	GLCSC Voluntary Legal Services Corp. Grant – $651,779 Revenue – $825,926 78.9%	La Cooperativa Campesina de California Grant – $20,731,666 Revenue – $20,732,484 99.9%
International Institute of Boston Grant – $75,000 Revenue – $4,759,184 1.6%	Chinese Newcomers Service Center Grant – $30,927 Revenue – $298,531 10.4%	Cambodian Association of Greater Philadelphia Grant – $124,780 Revenue – $329,700 37.8%	Community Action Board of Santa Cruz County, Inc. Grant – $1,285,360 Revenue – $1,922,277 66.9%	Greater Philadelphia Overseas Chinese Grant – $83,883 Revenue – $93,339 89.9%	La Crosse Area Hmong Mutual Assistance Association, Inc. Grant – $640,142 Revenue – $704,910 90.8%

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<=10 percent	*>10 percent – 25 percent*	*>25 percent – 50 percent*	*>50 percent – 75 percent*	*>75 percent – 90 percent*	*>90 percent – 100 percent*
International Institute of Greater Toledo, Inc. Grant – $2,932 Revenue – $198,388 1.5%	Coalition for Immigrant Refugee Rights & Services Grant – $268,806 Revenue – $1,778,268 15.1%	Caritas of Austin Grant – $1,445,550 Revenue – $4,222,534 34.2%	Concerned Citizens of Queens Cludadanos Conscientes of Queens 1 Grant – $108,184 Revenue – $191,042 56.6%	Hmong American Friendship Association, Inc. Grant – $595,462 Revenue – $747,478 79.7%	Latin American Immigrant & Refugee Organization, Inc. Grant – $184,114 Revenue – $189,533 97.1%
Japanese American Social Services, Inc. Grant – $1,470 Revenue – $212,274 0.7%	Farmworker Association of Florida, Inc. Grant – $136,502 Revenue – $1,274,580 10.7%	Catholic Charities of Orange County Grant – $1,959,596 Revenue – $4,298,103 45.6%	Council of Latino Agencies Grant – $198,425 Revenue – $306,364 64.8%	Hmong American Partnership Grant – $2,587,875 Revenue – $3,123,063 82.9%	Legal Services of New Jersey, Inc. Grant – $19,041,990 Revenue – $20,025,901 95.1%
Jewish Family and Children's Services (CA) Grant – $966,201 Revenue – $21,430,955 4.5%	Immigration Advocacy Services, Inc. Grant – $36,515 Revenue – $270,106 13.5%	Catholic Charities of San Jose Grant – $4,711,004 Revenue – $10,372,300 45.4%	Cuban American National Council, Inc. Grant – $3,002,862 Revenue – $5,329,433 56.3%	Indochinese Community Center Grant – $1,030,999 Revenue – $1,167,555 88.3%	National League of Cuban American Community Based Centers, Inc. Grant – $626,409 Revenue – $627,397 99.8%
Jewish Family and Children's Service (MN) Grant – $51,398 Revenue – $3,876,944 1.3%	International Institute of Rhode Island, Inc. Grant – $397,732 Revenue – $1,846,885 21.5%	Catholic Social Services Grant – $1,525,238 Revenue – $3,741,483 40.8%	East Central Illinois Refugee Mutual Assistance Center Grant – $70,002 Revenue – $99,888 70.0%	Interchurch Refugee & Immigration Ministries, Inc Grant – $2,089,986 Revenue – $2,337,931 89.4%	Private Industry Council of the City of New York Grant – $4,052,320 Revenue – $4,108,883 98.6%
Jewish Family Service of Rockland County, Inc. Grant – $27,500 Revenue – $278,362 9.9%	Jewish Council of Yonkers, Inc. Grant – $74,064 Revenue – $303,344 24.4%	Center for New Americans (CA) Grant – $19,913 Revenue – $42,322 47.1%	El Rescate Grant – $233,534 Revenue – $382,442 61.1%	Intercultural Mutual Assistance Association of SE Minnesota Grant – $641,530 Revenue – $759,149 84.5%	Refugee Services Alliance Grant – $1,693,052 Revenue – $1,832,953 92.4%

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ELECTRONIC REPRODUCTION PROHIBITED

<=10 percent	*>10 percent – 25 percent*	*>25 percent – 50 percent*	*>50 percent – 75 percent*	*>75 percent – 90 percent*	*>90 percent – 100 percent*
Justice Information Center, Inc. Grant – $36,182 Revenue – $650,047 5.6%	Jewish Family and Children's Services of the East Bay Grant – $473,188 Revenue – $2,431,551 19.5%	Dominicans Women's Development Center Grant – $244,572 Revenue – $493,476 49.6%	Ethiopian Community Association of Missouri Grant – $59,728 Revenue – $85,133 70.2%	International Center of Capital Region, Inc., Grant – $152,447 Revenue – $176,304 86.5%	Southeast Asian Mutual Assistance Association Grant – $129,333 Revenue – $130,585 99.0%
Korean Community Center of the East Bay Grant – $26,100 Revenue – $321,644 8.1%	Maryland Vietnamese Mutual Association, Inc. Grant – $7,250 Revenue – $53,875 13.6%	Ethiopian Community Center, Inc. Grant – $74,969 Revenue – $150,529 49.8%	Ethiopian Community Development Council Grant – $1,991,230 Revenue – $2,844,682 70.0%	Ireo Grant – $3,428,469 Revenue – $4,059,800 84.4%	South Jamaica Services for Families and Children, Inc. Grant – $2,113,350 Revenue – $2,113,350 100%
Latin American Association, Inc Grant – $64,765 Revenue – $3,467,239 1.9%	National Council of La Raza Grant – $3,085,192 Revenue – $13,533,734 22.8%	Gage County Economic Development Inc. Grant – $172,859 Revenue – $393,489 43.9%	Foreign-Born Information and Referral Network, Inc. Grant – $140,354 Revenue – $260,049 54.0%	Jewish Community Council of Greater Coney Island, Inc. Grant – $3,119,627 Revenue – $3,534,414 88.3%	Western Kentucky Refugee Mutual Assistance Society Grant – $715,715 Revenue – $715,715 100%
Lower East Side Tenement Museum Grant – $145,102 Revenue – $1,754,011 8.3%	Northwest Immigrants Rights Project Grant – $309,691 Revenue – $1,293,325 23.9%	Genesis Center Grant – $236,801 Revenue – $703,899 33.6%	Fresno Center for New Americans Grant – $536,079 Revenue – $1,011,409 53.0%	Kurdish Human Rights Watch, Inc. Grant – $845,520 Revenue – $1,004,090 81.0%	Wichita Indochinese Center, Inc. Grant – $458,613 Revenue – $481,935 95.2%
Lutheran Social Services of South Dakota, Inc. Grant – $710,219 Revenue – $8,767,032 8.1%	Political Asylum Project of Austin Grant – $38,352 Revenue – $353,837 10.8%	Hermandad Mexicana Nacional Grant – $431,037 Revenue – $1,098,479 39.2%	Greater Boston Legal Services, Inc. Grant – $5,075,509 Revenue – $8,831,041 57.5%	Libreria Del Pueblo, Inc. Grant – $743,824 Revenue – $881,314 84.4%	
New York Immigration Coalition, Inc. Grant – $5,863 Revenue – $1,661,678 0.4%	United Israel Appeal, Inc. Grant – $70,000,000 Revenue – $328,230,000 21.3%	Immigration Project, Inc. Grant – $44,414 Revenue – $122,167 36.4%	Hebrew Immigrant Aid Society of Chicago Grant – $287,680 Revenue – $550,146 52.3%	Social & Cultural RDI, Inc. Grant – $320,994 Revenue – $425,970 75.4%	

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<=10 percent	*>10 percent – 25 percent*	*>25 percent – 50 percent*	*>50 percent – 75 percent*	*>75 percent – 90 percent*	*>90 percent – 100 percent*
Spanish Catholic Center, Inc. Grant – $161,551 Revenue – $2,058,132 7.8%	U.S. Catholic Conference Diocesan Migrant and Refugee Grant – $52,482 Revenue – $442,030 11.9%	International Institute of Buffalo, Inc. Grant – $429,591 Revenue – $1,154,398 37.2%	Hispanic Committee of Virginia Grant – $535,283 Revenue – $942,651 56.8%	Tacoma Community House Grant – $2,052,243 Revenue – $2,567,969 79.9%	
Tucson Ecumenical Council Legal Assistance Grant – $9,206 Revenue – $177,617 5.2%		International Institute of San Francisco Grant – $416,725 Revenue – $1,093,025 38.1%	Interfaith Ministries for Greater Houston Grant – $2,250,721 Revenue – $4,009,636 56.1%	The Coalition of Florida Farmworker Organizations, Inc. Grant – $818,164 Revenue – $1,012,730 81.0%	
UJA Federation Westport – Weston – Wilton- Norwalk Grant – $3,510 Revenue – $1,044,558 0.3%		International Institute of the East Bay Grant – $466,472 Revenue – $1,037,134 45.0%	International Institute of Connecticut, Inc. Grant – $503,438 Revenue – $959,225 52.5%	Travelers & Immigrants Aid – Chicago Connection Grant – $13,795,743 Revenue – $15,399,794 89.6%	
U.S. Catholic Conference Associated Catholic Charities Grant – $134,637 Revenue – $2,345,223 5.7%		Jackson Heights – Elmhurst Kehillah Grant – $89,983 Revenue – $181,910 49.5%	International Institute of New Jersey Grant – $816,569 Revenue – $1,476,768 55.3%	Vietnamese Friendship Association Grant – $34,162 Revenue – $49,530 84.3%	
		La Comunidad Hispana, Inc. Grant – $275,050 Revenue – $771,848 35.6%	League of United Latin American Citizens Grant – $2,962,372 Revenue – $4,351,883 68.1%	Westchester Hispanic Coalition, Inc. Grant – $426,539 Revenue – $550,029 77.5%	

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<=10 percent	*>10 percent – 25 percent*	*>25 percent – 50 percent*	*>50 percent – 75 percent*	*>75 percent – 90 percent*	*>90 percent – 100 percent*
		La Raza Centro Legal – San Francisco Grant – $367,299 Revenue – $836,680 43.9%	Legal Aid Foundation of Los Angeles Grant – $5,995,348 Revenue – $8,434,076 71.1%		
		Making A Difference Grant – $89,252 Revenue – $191,339 46.6%	Legal Aid of Western Missouri Grant – $3,356,900 Revenue – $4,628,304 72.5%		
		Nassau County Hispanic Foundation, Inc. Grant – $21,280 Revenue – $84,565 25.2%	Los Angeles Center For Law and Justice Grant – $349,691 Revenue – $488,018 71.7%		
		National Immigration Forum, Inc. Grant – $285,976 Revenue – $1,055,515 27.1%	Mohawk Valley Resource Center for Refugees Grant – $1,152,937 Revenue – $1,757,230 65.6%		
		Nationalities Service Center of Philadelphia Grant – $521,988 Revenue – $1,405,556 37.1%	(The) Montagnard Dega Association, Inc. Grant – $89,739 Revenue – $135,870 66.9%		
		North Hudson Community Action Corp. Grant – $6,917,942 Revenue – $16,007,580 43.2%	Refugee & Immigrant Forum of Snohomish Grant – $646,032 Revenue – $900,194 71.8%		

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<=10 percent	*>10 percent – 25 percent*	*>25 percent – 50 percent*	*>50 percent – 75 percent*	*>75 percent – 90 percent*	*>90 percent – 100 percent*
		Northern Manhattan Coalition for Immigrants Rights Grant – $128,377 Revenue – $271,029 47.4%	Sacramento Chinese Community Service Center, Inc. Grant – $597,272 Revenue – $799,165 74.7%		
		Nosotros Grant – $248,928 Revenue – $725,979 34.3%	Saint Anselms Cross Cultural Community Center Grant – $880,697 Revenue – $1,207,978 72.9%		
		One Stop Immigration Center, Inc. Grant – $660,491 Revenue – $2,342,368 28.1%	South Asian Network, Inc. Grant – $95,329 Revenue – $129,677 73.5%		
		San Francisco Bar Association Volunteer Legal Services Program Grant – $801,232 Revenue – $2,229,059 35.9%	Spanish Speaking Citizens Foundation Grant – $447,729 Revenue – $629,932 71.1%		

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TABLE C

Government Grants to the 171 Non-Profit Organization Broken Down into Seven Monetary Ranges

<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
American Civic Association, Inc. Binghamton, NY Grant – $65,854 FY – 12/31/1999	African Community Refugees Center, Los Angeles, CA Grant – $363,768 FY – 6/30/1998	Asian Americans for Equality, Inc. New York, NY Grant – $573,993 FY – 12/31/1998	Acre Family Day Care Corp. Lowell, MA Grant – $1,852,031 FY – 12/31/1999	Catholic Charities of Diocese of San Diego, CA Grant – $8,326,861 FY – 6/30/1999	Catholic Charities Archdiocese of New Orleans, LA Grant – $14,046,180 FY – 6/30/1999	La Cooperativa Campesina de California Sacramento, CA Grant – $20,731,666 FY – 12/31/1998
Austin-Travis County Refugee Services, TX Grant – $73,405 FY – 9/30/1999	African Services Committee, Inc. New York, NY Grant – $477,508 FY – 5/31/1998	(The) Brooklyn Historical Society Brooklyn, NY Grant – $523,431 FY – 4/30/1998	Associated Catholic Charities Washington, DC Grants – $1,082,167 FY – 6/30/2000	Catholic Family & Community Services, Inc. Paterson, NJ Grant – $5,389,351 FY – 6/30/.1998	Catholic Social Center Service of Central and Northern Arizona, Phoenix, AZ Grant – $13,425,733 FY – 6/30/2000	United Israel Appeal New York, NY Grant – $70,000,000 FY – 12/31/1998
Ayuda Washington, DC Grant – $66,603 FY – 6/30/1999	Alse Clemente Center, Inc. East Chicago, IL Grant – $130,727 FY – 12/31/1998	Catholic Charities of Diocese of Rockford, IL Grant – $704,275 FY – 6/30/2000	Associated Catholic Charities of Diocese of Galveston-Houston, TX Grant – $2,279,026 FY – 12/31/1998	Chicago Health Outreach, Inc. Chicago, IL Grant – $8,619,326 FY – 6/30/2000	Legal Services of New Jersey, Inc. Edison, NJ Grant – $19,041,990 FY – 12/31/1999	
Boat People SOS, Inc. Fairfax, VA Grant – $41,250 FY – 12/31/1999	Asian Law Caucus, Inc. San Francisco, CA Grant – $189,836 FY – 6/30/2000	Catholic Charities USA Alexandria, VA Grant – $800,292 FY – 12/31/1998	Caritas of Austin Austin, TX Grant – $1,445,550 FY – 9/30/1999	Greater Boston Legal Services, Inc. Boston, MA Grant – $5,075,509 FY – 12/31/1999	Travelers & Immigrants Aid – Chicago Connection Chicago, IL Grant – $13,795,743 FY – 6/30/2000	

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
Catholic Charities Diocese of Beaumont, TX Grant – $58,483 FY – 6/30/1999	Asian Women United St. Paul, MN Grant – $131,297 FY – 6/30/1999	Catholic Legal Immigration Network Washington, DC Grant – $565,948 FY – 12/31/1998	Catholic Charities, Inc. Wilmington, DE Grant – $4,915,876 FY – 6/30/1999	International Institute of Los Angeles, CA Grant – $9,730,023 FY – 6/30/1998		
Catholic Social Services of Santa Fe, NM Grant – $31,411 FY – 6/30/1999	Asociacion Pro Sevicios Sociales, Inc. Laredo, TX Grant – $195,890 FY – 12/31/1998	Fresno Center for New Americans Fresno, CA Grant – $536,079 FY – 12/31/1999	Catholic Charities of Orange County, Santa Ana,, CA Grant – $1,959,596 FY – 6/30/1999	Legal Aid Foundation of Los Angeles, CA Grant – $5,995,348 FY – 6/30/1999		
Center for Educational Telecommunications, Berkeley, CA Grant – $33,000 FY – 12/31/1997	Bridge Refugee and Sponsorship Services, Inc. Knoxville, TN Grant – $436,380 FY – 12/31/1999	GLCSAC Voluntary Legal Services Corp. Los Angeles, CA Grant – $651,779 FY – 6/30/1998	Catholic Charities of San Jose, CA Grant – $4,711,064 FY – 6/30/1998	North Hudson Community Action Corp. West New York, NJ Grant – $6,917,942 FY – 1/31/1999		
Center for New Americans Walnut Creek, CA Grant – $19,913 FY – 12/31/1999	Brooklyn Chinese American Association Brooklyn, NY Grant – $429,132 FY – 6/30/1998	Hispanic Committee of Virginia, Falls Church, VA Grant – $535,283 FY – 6/30/1999	Catholic Charities of Southern Nevada Las Vegas, NV Grant – $4,998,756 FY – 6/30/1999			
Central American Legal Assistance Brooklyn, NY Grant – $15,000 FY – 12/31/998	Camba Legal Services, Inc. Brooklyn, NY Grant – $392,967 FY – 6/30/2000	Hmong American Friendship Association, Inc. Milwaukee, WI Grant – $595,462 FY – 12/31/1999	Catholic Social Services, Inc. Atlanta, GA Grant – $1,525,238 FY – 6/30/2000			

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
Central American Resource Center of California, Los Angeles, CA Grant – $40,504 FY – 12/31/1997	Cambodian Association of Greater Philadelphia Philadelphia, PA Grant – $124,780 FY – 3/31/1999	Intercultural Mutual Assistance Association of SE Minnesota, Inc. Rochester, MN Grant – $641,530 FY – 6/30/2000	Catholic Social Services of Albuquerque, NM Grant – $1,919,459 FY – 6/30/1999			
Chinese Newcomers Service Center San Francisco, CA Grant – $30,927 FY – 6/30/1998	Cambodian Mutual Assistance Association Columbus, OH Grant – $169,677 FY – 6/30/1998	International Institute of Connecticut, Bridgeport, CT Grant – $503,438 FY – 12/31/1998	Chinatown Service Center Los Angeles, CA Grant – $2,255,799 FY – 6/30/1999			
Church Alive Bronx, NY Grant – $5,000 FY – 12/31/1998	Cambodian Mutual Assistance Association of Greater Lowell, Lowell, MA Grant – $195,865 FY – 6/30/2000	International Institute of New Jersey Jersey City, NJ Grant – $816,569 FY – 9/30/2000	Community Action Board of Santa Cruz County, CA Grant – $1,285,360 FY – 12/31/1998			
Colombian American Service Association, Inc. Miami, FL Grant – $3,858 FY – 12/31/1999	Catholic Charities Diocese of Venice, FL Grant – $347,528 FY – 6/30/1999	Jewish Family and Children's Services San Francisco, CA Grant – $966,201 FY – 6/30/1999	Cuban American National Council Miami, FL Grant – $3,002,862 FY – 12/31/1998			
Community Legal Services and Counseling Center, Inc. Cambridge, MA Grant – $35,000 FY – 6/30/1999	Center for Cultural Dynamics Englewood, CO Grant – $142,740 FY – 6/30/1999	Kurdish Human Rights Watch Fairfax, VA Grant – $845,520 FY – 12/31/1999	Ethiopian Community Development Council Arlington, VA Grant – $1,991,230 FY – 9/30/1999			

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
East Central Illinois Refugee Mutual Assistance Center Urbana, IL Grant – $70,002 FY – 6/30/1999	Center for New Americans Northampton, MA Grant – $401,392 FY – 8/31/2000	La Crosse Area Hmong Mutual Assistance Association, Inc. La Crosse, WI Grant – $640,142 FY – 9/30/2000	Hmong American Partnership St. Paul, MN Grant – $2,587,875 FY – 12/31/1999			
Ethiopian Community Association of Missouri St. Louis, MO Grant – $59,728 FY – 6/30/1999	Centre for Asians and Pacific Islanders Minneapolis, MN Grant – $376,118 FY – 12/31/1998	Libreria Del Pueblo San Bernardino, CA Grant – $743,824 FY – 6/30/1999	Immigrant Center Honolulu, HI Grant – $2,683,170 FY – 6/30/2000			
Ethiopian Community Center, Inc. Washington, DC Grant – $74,969 FY – 12/31/1998	Centro Legal, Inc. St. Paul, MN Grant – $128,104 FY – 12/31/1999	Lutheran Social Services of South Dakota Sioux City, SD Grant – $710,219 FY – 6/30/1999	Indochinese Community Center Washington, DC Grant – $1,030,999 FY – 6/30/1999			
Farmworker Justice Fund, Inc. Washington, DC Grant – $86,012 FY – 9/30/1998	Centro Romano Chicago, IL Grant – $277,163 FY – 12/31/1998	National League Cuban American Community Based Centers Fort Wayne, IN Grant – $626,409 FY – 6/30/1999	Interchurch Refugee and Immigration Ministries, Inc. Chicago, IL Grant – $2,089,986 FY – 6/30/2000			
Greater Philadelphia Overseas Chinese Association, PA Grant – $83,883 FY – 12/31/1998	Coalition for Immigrant Refugee Rights & Services San Fran., CA Grant – $268,806 FY – 12/31/1997	Nationalities Service Center of Philadelphia, PA Grant – $521,988 FY – 5/31/1998	Interfaith Ministries for Greater Houston, TX Grant – $2,250,721 FY – 12/31/1998			

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
Immigration Advocacy Services, Inc. Astoria, NY Grant – $36,515 FY – 12/31/1998	Concerned Citizens of Queens – Chidadanos Conscientes of Queens I Corona, NY Grant –$108,184 FY – 12/31/1998	One Stop Immigration Center, Inc. Los Angeles, CA Grant – $660,491 FY – 9/30/1997	Irco Portland, OR Grant – $3,428,469 FY – 9/30/1999			
Immigration Project, Inc. Staunton, IL Grant – $44,414 FY – 6/30/1999	Council of Latino Agencies, Washington, DC Grant – $198,425 FY – 9/30/1998	Refugee & Immigrant Forum of Snohomish Everett, WA Grant – $646,032 FY – 9/30/1999	Jewish Community Council of Gr. Coney Island Brooklyn, NY Grant – $3,119,627 FY – 6/30/1999			
International Institute of Boston Boston, MA Grant – $75,000 FY – 6/30/1999	Dominican Women's Development Center New York, NY Grant – $244,572 FY – 9/30/1998	Sacramento Chinese Community Service Center Sacramento, CA Grant – $597,272 FY – 6/30/1999	League of United Latin Americans Washington, DC Grant – $2,962,372 FY – 9/30/1999			
International Institute of Greater Toledo, Toledo, OH Grant – $2,932 FY – 12/31/1998	Eau Claire Area Hmong Mutual Assistance Association, Inc. Eau Claire, WI Grant – $300,012 FY – 9/30/1999	Saint Anselms Cross Cultural Community Center Garden Grove, CA Grant – $880,697 FY – 9/30/1998	Legal Aid of Western Missouri, Kansas City, MO Grant – $3,356,900 FY – 12/31/1999			
Jackson Heights – Elmhurst Kehillah Jackson Heights, NY Grant – $89,983 FY – 6/30/1999	El Rescate Los Angeles, CA Grant – $233,534 FY – 12/31/1997	San Francisco Bar Association Volunteer Legal Services, CA Grant – $801,232 FY – 12/31/1998	Mohawk Valley Resource Center for Refugees Utica, NY Grant – $1,152,937 FY – 2/28/2000			

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
Japanese American Social Services, Inc. New York, NY Grant – $1,470 FY – 6/30/1999	Episcopal Social Service of the Diocese of Connecticut, Inc. New Haven, CT Grant – $360,080 FY – 12/31/1999	The Coalition of Florida Farmworker Organizations Homestead, FL Grant – $818,164 FY – 9/30/1999	National Council of La Raza Washington, DC Grant – $3,085,192 FY – 9/30/1998			
Jewish Council of Yonkers, Inc. Yonkers, NY Grant – $74,064 FY – 6/30/1999	Farmworker Association of Florida, Apopka, FL Grant – $136,502 FY – 8/31/1998	United Cambodian Association of Minnesota, Inc. St. Paul, MN Grant – $605,330 FY – 12/31/1999	Private Industry Council of the City of New York New York, NY Grant – $4,052,320 FY – 6/30/1999			
Jewish Family and Children's Services Minneapolis, MN Grant – $51,398 FY – 8/31/1998	Foreign-Born Information and Referral Network, Inc. Columbia, MD Grant – $140,354 FY – 6/30/1999	Vietnamese Association of Illinois, Chicago, IL Grant – $806,438 FY – 6/30/2000	Refugee Services Alliance Houston, TX Grant – $1,693,052 FY – 9/30/1999			
Jewish Family Services of Rockland County New City, NY Grant – $27,500 FY – 6/30/1999	Gage County Economic Development Inc. Beatrice, NE Grant – $172,859 FY – 9/30/1999	Vietnamese Social Services of Minnesota St. Paul, MN Grant – $692,636 FY – 12/31/1999	South Jamaica Services for Families & Children Richmond Hill, NY Grant – $2,113,350 FY – 12/31/1998			
Justice Information Center, Inc. Denver, CO Grant – $36,182 FY – 12/31/1998	Genesis Center Providence, RI Grant – $236,801 FY – 8/31/1998	Western Kentucky Refugee Mutual Assistance Soc. Bowling Green, KY Grant – $715,715 FY – 6/30/199	Tacoma Community House Tacoma, WA Grant – $2,052,243 FY – 12/31/1999			

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
Korean Community Center of the East Bay Oakland, CA Grant – $26,100 FY – 12/31/1998	Haitian Community Refugee Center Los Angeles, CA Grant – $170,707 FY – 3/31/2000					
Latin American Association, Inc. Atlanta, GA Grant – $64,765 FY – 6/30/1999	Hebrew Immigrant Aid Society of Chicago, IL Grant – $287,680 FY – 6/30/1999					
Making A Difference Foundation Virginia Beach, VA Grant – $89,252 FY – 12/31/1999	Hermandad Mexicana Nacional Los Angeles, CA Grant – $431,037 FY – 6/30/1999					
Maryland Vietnamese Mutual Association Wheaton, MD Grant – $7,250 FY – 12/31/1999	International Center of Capital Region, Inc. Albany, NY Grant – $152,447 FY – 12/31/1998					
(The) Montagnard Dega Association, Inc. Greensboro, NC Grant – $89,739 FY – 6/30/1998	International Institute of Buffalo Buffalo, NY Grant – $429,591 FY – 10/31/1998					

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
Nassau County Hispanic Foundation Garden City, NY Grant – $21,280 FY – 6/30/1998	International Institute of Rhode Island Providence, RI Grant – $397,732 FY – 6/30/1999					
New York Immigration Coalition, Inc New York, NY Grant – $5,863 FY – 7/31/1999	International Institute of San Francisco, San Francisco, CA Grant – $416,725 FY – 6/30/1999					
Political Asylum Project of Austin Austin, TX Grant – $38,352 FY – 12/31/1999	International Institute of the East Bay, Oakland, CA Grant – $466,472 FY – 6/30/1998					
South Asian Network, Inc. Artesia, CA Grant – $95,329 FY – 12/31/2000	Jewish Family and Children's Services of the East Bay Berkeley, CA Grant – $473,188 FY – 6/30/2000					
Tucson Ecumenical Council Legal Assistance, Tucson, AZ Grant – $9,206 FY – 12/31/1997	La Comunidad Hispana Kennett, PA Grant – $275,050 FY – 6/30/1999					

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
UJA Federation Westport-Weston-Wilton-Norwalk, CT Grant – $3,510 FY – 8/31/1998	La Raza Centro Legal San Francisco, CA Grant – $367,299 FY – 6/30/1999					
U.S. Catholic Conference Diocesan Migrant and Refugee El Paso, TX Grant – $52,482 FY – 6/30/1999	Latin American Immigrant & Refugee Organization, Inc. West Palm Beach, FL Grant – $184,114 FY – 12/31/1999					
Vietnamese Friendship Association Seattle, WA Grant – $34,162 FY – 12/31/1999	Los Angeles Center of Law and Justice, CA Grant – $349,691 FY – 6/30/1999					
	Lower East Side Tenement Museum New York, NY Grant – $145,102 FY – 6/30/1999					
	National Immigration Forum, Inc. Washington, DC Grant – $285,976 FY – 12/31/1999					

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
	Northern Manhattan Coalition for Immigrant Rights New York, NY Grant – $128,377 FY – 12/31/1998					
	Northwest Immigrants Rights Project Seattle, WA Grant – $309,691 FY – 12/31/1999					
	Nosotros Tucson, AZ Grant – $248,928 FY – 6/30/1999					
	Social & Cultural RDI, Inc. Houston, TX Grant – $320,994 FY – 12/31/1999					
	Southeast Asian Mutual Assistance Association Garden City, KS Grant – $129,333 FY – 12/31/1999					

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<$100,000	$100,000 – $500,000	>$500,000 – $1 million	>$1 million – $5 million	>$5 million – $10 million	>$10 million – $20 million	>$20 million
	Southeast Asian Refugee Community Home – Search Minneapolis, MN Grant – $104,830 FY – 12/31/1999					
	Spanish Catholic Center Washington, DC Grant – $161,551 FY – 6/30/199					
	Spanish Center Joliet, IL Grant – $130,472 FY – 12/31/1998					
	Spanish Speaking Citizens Foundation Oakland, CA Grant – $447,729 FY – 6/30/1999					
	U.S. Catholic Conference Associated Catholic Charities Oklahoma City, OK Grant – $134,637 FY – 6/30/1998					
	Vive, Inc. Buffalo, NY Grant – $362,265 FY – 6/30/1999					

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<$100,000	*$100,000 – $500,000*	*>$500,000 – $1 million*	*>$1 million – $5 million*	*>$5 million – $10 million*	*>$10 million – $20 million*	*>$20 million*
	Westchester Hispanic Coalition, Inc. White Plains, NY Grant – $426,539 FY – 6/30/1999					
	Wichita Indochinese Center, Inc. Wichita, KS Grant – $458,613 FY – 12/31/1997					
	Women's Association of Hmong and Lao St. Paul, MN Grant – $434,119 FY – 12/31/1999					

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Book Reviews

High-Flying Adventures in the Stock Market
Molly Baker
John Wiley and Sons, 2001

The idea behind this book (John Wiley & Sons, 2000) is simple. The author (Molly Baker) got permission to sit in the offices of the managers of one of the countries most successful mutual funds, Delaware Aggressive Growth (and a couple of other growth funds). From there she reported on what she observed as Jerry Frey (the portfolio manager) invested over two billion dollars on behalf of growth mutual funds. This format gives a picture of the workings of fund managers that could not be obtained from other sources (textbooks, articles, etc.). Someone thinking of taking a job with such a money manger will find this of interest, as will many who entrust their money to such managers. The disadvantage to such a day-by-day account is much trivia and filler. The book describes office conversations and other day-to-day events. For instance, the "water-cooler" type conversations in such a firm resembles what one would observe in other firms. I suspect some readers would rather skip such details.

This article will discuss some of the important questions reading the book brings to mind (or at least this reviewer's mind) and put them into context. For one who is entrusting his retirement money to a mutual fund or for one concerned with the health of the economy, it is scary how short term oriented this group is, and how little real thought seems to go into stock picking. Describing the financial market's role in allocating capital, the economist views investors as deeply analyzing much information about potential investments and calmly basing decisions on firms' long run prospects. It is clear from this book that the managers receive much information. Jerry Frey's stack of incoming mail is described as typically two feet thick. However, it is also clear that much of it is never even looked at. Decisions seem to be based on salesman's tips or other superficial factors.

Much of the trading (speculating) the book describes appears based on short run considerations, including observations of how a stock is acting from watching the screen. Rather than experts spending long periods of time deeply examining companies and projecting their futures, the book describes people sitting at their terminals watching stocks

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trade and exchanging rumors with their institutional salesmen. The book's action takes place in the second half of 1998, a highly speculative period. This was when the Internet boom was in progress (see Miller and Mazumder 2001).

Baker depicts the stock picking team's goal as beating the competition and ending up with the best record at year-end. There are reasons why the year-end is so important. These managers' compensation, as that of most who manage money, is partially through year-end bonuses. In this firm, as in many others, the bonuses are based on how the team did relative to the competition. Thus it is entirely rational for the team to be constantly watching the competition and worrying about how they will rank at year-end, when the score is computed.

Their compensation system was designed this way for good reasons. In deciding which mutual fund to invest their money with, investors give heavy weight to rankings of fund returns, especially with regard to funds in the same category (such as small capitalization growth funds).

Yet the various academic studies repeatedly show that mutual fund returns exhibit very little predictability. Buying a top ranked fund rather than the average fund does not appreciably improve your expected return (Brown and Goetzmann, 1995, Cai, Chan and Yamada, 1997, Elton, Gruber, and Blake 1996; Lehmann and Modest, 1987, Sharpe, 1996). Indeed, there is some evidence that investors who allocate money to the best performing categories actually hurt their performance by about 1% per year (Nesbitt, 1995). At most, there seems to be some benefit from avoiding the funds that did well below average. These poorly performing funds are frequently those handicapped by high expenses and the costs of excessive trading.

As important as the end of the year score is to the fund companies and the fund managers, there is no reason for investors to attach any particular importance to that date. Investors should want high return at acceptable risk calculated over all time periods, not merely those ending December 31. It is easy to imagine how the focus on year-end rankings can lead to investment decisions contrary to the investors' interests. In terms of attracting new money one does much better to be first than to be merely highly ranked. Maximizing the probability of ending the year as number one will often require taking big risks. Yet such big risks may not be in the interests of the fund's investors. It will be especially bad for those investors who have all their money in this single fund. Admittedly, most funds will limit the size of their investment in a single stock. The funds whose management was discussed

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here limited investment in any single stock to 5%. However, a fund can increase its chance of being number one by placing a big bet on a particular theme such as biotechnology, genomics, regional airlines, etc.

Molly Baker frequently refers to decisions that were basically questions of how much risk to take. However, the risk consideration she describes are not so much risk to the investor's wealth as risk to the managers and their bonuses. The risk she describes was of under performing the competition (a risk to the managers), not losing the investors' money (a risk to the investors).

If part way through the year a fund has a shot at being number one, the way to maximize the probability of being number one is to take big risks. This is profit maximizing since top ranked funds attract so much new money. However, attracting new money does not making the existing investors better off. Indeed, Becker and Vaughan (2001) show that new money will actually make the existing investors in a fund worse off. Intuitively, if more money is attracted than can be profitably invested in the manager's best ideas, existing investors can be worse off.

The description of the reward system for managers makes it very clear that it can induce manager to make "bet the fund" bets that are not in the investors' interest. Because funds are required to reveal their holdings only twice a year, it is very hard to discover what risks were taken with the owner's money. A fund shooting to be number one might make a bet during several months on a narrow sector (say Internet retailing) and then reduce the bet just before the end of the year so that it would again look diversified. The fund owners might never learn the risk that was taken. At worst it may be obvous that the managers lost much of their money, but it need not be apparent how they lost it. An obvious solution for this problem is to require that funds make available a record of their trades, possibly on the Internet.

The account in the book contains numerous accounts of "deals," or initial public offerings. The fund managers often had a low opinion of the companies whose shares they were offered a chance to buy, with their opinions of their merits being expressed in scatological form. Yet they very frequently bought them. The reason is not hard to discover. This was during the great Internet bubble (see Miller and Mazumder 2001). Virtually every initial public offering initially traded at a premium over the offering price. Thus, it is not surprising that the policy was to purchase virtually any initial public offering that appeared hot. The payoff was huge. Geocities went public at $17 per share (Frey bought 20,000 shares at this price) and sold them two days later for

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$44.67, for a half a million-dollar profit (p. 111). At the initial Ebay opening, Frey bought 15,500 shares at $18, and sold them two days later for $45, again giving a profit of over half a million dollars (p. 205). A firm name E-Tek opened at $12 a share and went in one day to $24. Profit is given as $365,000 for the fund (p. 226).

It is clear the mutual funds were free to flip most of the initial public offerings they participated in. Flipping refers to the process of buying an initial public offering from the underwriter at the offering price and then selling it immediately afterwards when it opens for trading. This can provide some incredible profits.

Individuals are excluded from these profits. An individual investor who turns around and immediately sells an initial public offering will not be able to purchase another one from that brokerage firm. To purchase at the offering price, individuals have to be prepared to hold for at least months and usually longer. It appears unfair, and is unfair, that individuals do not have the same profit opportunities as funds have.

Some of this difference in treatment appears to arise from the role of custodians in institutional investing. Custodians hold the stocks owned by mutual funds and other institutional investors. Among other things, this makes sure that the managers cannot abscond with the securities. The custodian receives the securities a fund purchases at the initial public offering. Should the fund choose to sell them almost immediately, they can go to another brokerage firm and have them execute the sale. The underwriter need not know that they were flipped.

Individual investors however normally have the securities held by the brokerage firm they buy them through. While the firm is legally obliged to sell them if ordered to do so, they do know when you flipped them and can (and do) make sure you do not get allocations of future desirable initial public offerings.

It is clear from Molly Baker's account that a good part of the profits earned by the growth funds discussed came from their success at getting allocations of initial public offerings. However it is not known how much. Funds should be required to disclose how much of their earnings come from IPO's.

The underwriter determines who gets the new shares in a hot issue (p 23). While they claim to give some weight to the goals of the firm being underwritten (such as a wide distribution of shares or finding long term shareholders), they actually appear to distribute the shares so as to maximize the underwriter's profits. This usually means giving shares in a hot issue to those who have previously given the underwriter much

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business. Active traders, such as the funds chronicled here, would have generated much investment business and would be rewarded with relatively large allocations. Paradoxically, even if a fund on average lost on a typical trade (because the costs of the trade exceeded the benefit), the increased access to initial public offerings could result in the active traders having the best performance.

Although Molly Baker assures us that the management is scrupulously fair in allocating investment opportunities between the three different funds it manages, the current system seems ripe for abuse. It is well known that investors prefer to invest in funds that do well in the return rankings (even though the academic studies cited earlier suggest history tells little about future performance). The very mathematics of return computations show that in a small fund a few successful initial public offerings can make a big difference to how it performs. Investment banks think of their customers as being the management companies, not the individual funds. In turn, it is their best customers who get the preferential allocations of hot initial public offerings. It would seem very plausible that fund management companies would allocate the "hot" offerings to certain small funds whose reputation they were trying to establish.

These are some of the interesting questions raised by the book's day-by-day account of life in a mutual fund management office.

Edward Miller

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The Death of the West
Patrick J. Buchanan
St. Martin's Press, 2002

Is it possible simultaneously to be a successful political figure, aspiring to the presidency of the United States, and at the same time a serious writer on social and cultural issues? The question almost answers itself. Those who have read Patrick Buchanan's books know that he certainly is a serious writer. What is doubtful is whether honest and open thinking isn't inherently a disqualification for political success. "Truth-telling" would lead to popularity only in a world where truth is valued above special interests and above the desire people have to the confirmed comfortably in the views they already hold.

Here, fortunately, we are concerned not with Buchanan the politician, but with Buchanan the philosopher and social critic.

The significance of Buchanan's writing stems in large part from the topics he chooses. He doesn't shy away from any subject he considers vital to the well-being or survival of Western civilization or its American derivative. His recent book A Republic, Not an Empire (reviewed in these pages in the Summer 2000 issue) explored the risks of the United States' self-proclaimed mission in world affairs (since the great turn-about of 1898) "to make everybody's business our business." The danger of a well-intended interventionism was made crystal clear by the horrors of September 11. A world-wide Social Gospel sought to be impressed by a powerful nation manages to incur much resentment and fierce animosity.

That book is now followed by The Death of the West, which has perhaps an even more sweeping vision. Buchanan makes a powerful case that the West is permitting itself to die. Like the exoskeleton of a dead or dying insect, the corpus of the old civilization is coming to be occupied by new life: a multicultural, heavily Third World population. Already, the West is much different than it was even so recently as forty

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years ago; in the near future, it will be hard to recognize, except by the remains of its historic architecture.

Buchanan's discussion centers on several "clear and present dangers" to the survival of Western civilization (which are in addition to the danger from world interventionism he described in his preceding book):

1. A radical decline of the existing population.

A drastic decline in population through aging, mortality and a far-below-replacement birthrate is occurring everywhere in the West except in Muslim Albania. Whereas demographic experts say that there needs to be an average 2.1 children per woman for a people simply to maintain its existing population, fertility rates in Western countries have fallen well below this for several years. The number is now 1.4 for European women in general. Without immigration, Europe's population is expected to fall from the present 728 million to 600 million in fifty years. "Of Europe's 47 nations, only one, Muslim Albania, was, by 2000, maintaining a birthrate sufficient to keep it alive indefinitely."

Buchanan gives the following statistics by country: He says that Australia's birthrate is "below replacement," but he doesn't cite a figure. Germany, 1.3 for the past ten years. Great Britain, 1.66. Italy, 1.2. Russia, 1.17. (Russia's President Putin is prompted by this to warn his countrymen that "if the present tendency continues, there will be a threat to the survival of the nation." It is worth noting that Russia will over time be subject to increasing pressure from the burgeoning populations of the Muslim countries to its south and of China. Millions of Chinese are already settling in Siberia, radically changing the demographics of that vast expanse.) Spain has the lowest birthrate with 1.07. Even Japan, not a Western power but one of the advanced societies, is among the nations with a below-replacement birthrate. Buchanan says, "she, too, has begun to die. Japan's birthrate is half what it was in 1950."

Buchanan, taking a long view, is no doubt right about the danger this poses to the West. Nevertheless, the projected 600 million for 2050 is still considerably larger than the population of Europe was through most of its history. Taken just by itself, the decline in population, which is not necessarily subject to extrapolation into the indefinite future, does not deprive the civilization of the people it needs to exist and to thrive. The danger would seem to come, instead, from the combination of this decline with the second factor Buchanan discusses: the enor-

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mous demographic invasion that the rapid influx of immigrants from the Third World represents. Europe, the United States and Australia have for a third of a century allowed a vast wave of Third World immigration, some of it "legal" and some "illegal."

2. *A host of people from different cultures and a regnant ideology of "multiculturalism."*

Buchanan tells how "mass immigration has already begun. In [the single year of] 2000, England took in 185,000 immigrants, a record. In 1999 [again, a single year], 500,000 illegal aliens slipped into the European Union, a tenfold increase from 1993." At the same time, the United States insists on the admission of Turkey to the EU, a membership that would allow its citizens to migrate throughout Europe. It is no wonder that Buchanan says "the day of Europe is over... As their populations become more Arabic and Islamic, paralysis will set in."

In the United States, there have been "waves of Mexican immigrants" since the passage of the Immigration Act of 1965. The threat Buchanan sees from this does not result from some narrow xenophobia, or from an animus against the immigrants as human beings, but from the danger that is posed to the continuity of American civilization: "Unlike the immigrants of old, who bade farewell forever to their native lands when they boarded the ship, for Mexicans, the mother country is right next door. Millions have no desire to learn English or to become citizens. America is not their home; Mexico is; and they wish to remain proud Mexicans." He observes that "with their own radio and TV stations, newspapers, films, and magazines, the Mexican Americans are creating an Hispanic culture separate and apart from America's larger culture. They are becoming a nation within a nation." There is even a movement called "the reconquista" that aspires to a separate "mestizo nation."

This is reenforced by the ideology that the American Left, dominant within American institutions and followed implicitly by the professional classes, has embraced since World War II. This ideology marries the alienation of the American "intelligentsia" to every unassimilated or disaffected group, replacing the "Old Left's" desired marriage of the intelligentsia with the "proletariat." The resulting "multiculturalist" ideology is advanced under the name of the traditional American ideals of equality-before-the-law and of the dignity of each individual person, and thus has had an irresistible moral appeal, but has been far more than that. The result has been what both sides call "the culture war." In

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the struggle over the soul of America, the majority becomes increasingly dispirited and confused, while year by year the Left is strengthened by the rapidly changing demographics.

3. *The destruction of American memory; an "adversary culture" at war with mainstream American society.*

Buchanan gives considerable attention to the culture-war for its own sake. By itself, it would be changing the face of America even in the absence of reenforcement from the demographic revolution.

He gives the clearest explanation I have seen of the more recent roots of the adversary culture as they are found in the "Frankfurt School" made up of the leftist theoreticians Georg Lukacs, Antonio Gramsci, Theodor Adorno, Herbert Marcuse and their followers. This school has been central to the Left's "march through the institutions" of Europe and the United States. The Left has come to occupy virtually all the West's opinion-forming high ground. The remainder of the population – hundreds of millions of people – occupy a silent majority with little voice and only relatively inaudible whimpers of protest.

A criticism of Buchanan's explanation, which centers on those particular thinkers, would be, of course, that the intellectual and cultural "march" through the institutions of an otherwise "bourgeois" civilization has been going on for much longer than the explanation suggests. The Frankfurt School is simply a highly influential twentieth century manifestation of it. It can be traced back as far as Rousseau in the mid-eighteenth century. In his prize-winning essay on The Origins of Inequality, Rousseau declared his alienation from all advanced civilization, saying that private property is the root of most if not all social evil. Rousseau has had tens of thousands of followers in the literary-artistic subculture during the ensuing 250 years. This became especially evident with the rise of the world Left beginning in approximately 1820. The alienated critique of "bourgeois culture" has provided the steady drumbeat of modern art, literature and ideology. (This is not to say that that is all there has been; a great many creative people have worked outside its channel; but it has been a movement of vast and varied dimensions, constituting one of the major forces in modern life.)

The condition of the existing culture in the West as Buchanan describes it, although in no way exaggerated, would befit Jonathan Swift's description of his fictional Yahoos. He speaks of "a popular culture that is saturated with raw sex and trumpets hedonistic values," and says "the moral code... has been overthrown. The culture is dying." (The

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preference for sexually explicit movies, television and dress is often attributed to the preferences of the young, but it is worth observing how shallow that explanation is. The very young don't write the screenplays or the scripts for TV sitcoms; nor do they set the fashions that are marketed in the stores and trumpeted in commercials. Adults do those things, and it is adults who are choosing to take the culture in those directions.)

Those who think in secular terms will tend to downplay the religious aspect, but to Buchanan the attack on Christianity which he sees as the fundamental core of Western civilization looms as a fact of major importance. He speaks of "the de-Christianization of the West." He sees moral relativism as having taken the place of a fixed moral code based on religious belief. Buchanan is perhaps best known to people who have not read his books for his opposition to abortion and championing of Christian belief. There is no question but that this informs his outlook. The Death of the West has much to say, however, to Christian and secularist alike.

This review has highlighted Buchanan's main themes. The book itself, of course, is recommended for a much more thorough discussion.

Dwight D. Murphey

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The Pivot of Civilization

By Margaret Sanger. Women are the mainstay of the nation is the theme of the author in this republication of an epoch-making book by one of the pioneers of feminism and birth control (the founder of Planned Parenthood). Sanger has since been labeled a racist because of her concern that "those least fit to carry on the race are reproducing most rapidly" and her fear that a Third World population explosion would destroy any hope of humankind ever making this world into a terrestrial paradise. She believed that because of the significance of heredity, it was important that the fittest should reproduce more prolifically than the unfit. Every generation is to be regarded as a genetic bottleneck which serves to determine the future of the human race.

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